

BUILDING PROSPERITY IN LATIN AMERICA: INVESTOR CONFIDENCE IN THE RULE OF LAW

HEARING BEFORE THE SUBCOMMITTEE ON THE WESTERN HEMISPHERE OF THE COMMITTEE ON FOREIGN AFFAIRS HOUSE OF REPRESENTATIVES ONE HUNDRED THIRTEENTH CONGRESS

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WEDNESDAY, JULY 30, 2014

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON THE WESTERN HEMISPHERE,
COMMITTEE ON FOREIGN AFFAIRS,
Washington, DC.

The subcommittee met, pursuant to notice, at 2:05 p.m., in room 2200 Rayburn House Office Building, Hon. Matt Salmon (chairman of the subcommittee) presiding.

Mr. SALMON. A quorum being present, the subcommittee will come to order. I will start by recognizing myself and the acting ranking member today, Mr. Connolly, is acting as the ranking member. Mr. Sires took ill today and we miss him, but we are thrilled to have Mr. Connolly here today. And without objection, the members of the subcommittee can present brief remarks if they choose or they can submit them for the record. And now I will yield myself as much time as I may consume to present my opening remarks.

Good afternoon and welcome to this hearing on Investor Confidence in the Rule of Law in the Western Hemisphere. This hearing is really just a confirmation of our subcommittee's effort to be at the forefront of the discussion of how to bring greater growth and prosperity to our hemisphere. And as I have said countless times before, the United States should be unapologetic in promoting the principles of entrepreneurship, economic freedom, and free trade. Indeed, the promotion of these principles is a powerful foreign policy tool that can bring freedom and democracy to people all over the world. The crucial element to all of this though is the rule of law. Unless there is transparency, predictability, and the clear laws that are not subject to the whim of the executive, investors will lose confidence and entrepreneurs will look for better markets in which to launch their innovations and create jobs.

The humanitarian crisis along our border underscores the importance of policies to promote economic freedom and the rule of law to bring about opportunity, peace, and prosperity. We are seeing thousands of children taking a treacherous journey at the mercy of human smugglers from Central America up to the United States. It is true that the President's statements undermining our immigration laws have increased and encouraged this mass migration

havoc but these children are desperately trying to get away from countries that lack rule of law and economic opportunity.

Elsewhere in the region, we have seen leftist populist leaders systematically undermine the rule of law, while enacting policies that have all but destroyed their economies. Venezuela, a nation rich in resources continues to face record inflation, scarcity, and insecurity. An economist at Goldman Sachs recently said that the level of macro economic dysfunction in Venezuela is so deep that the story is no longer just about oil prices. Meanwhile, Heritage Foundation's index of economic freedom described Venezuela as having perfected the art of the 21st century corruption where government leaders act with complete impunity where their entire formal economy now operates on a black market.

President Maduro combines gross mismanagement of Venezuela's economy with undemocratic and heavy-handed tactics to silence his critics, from the violent crackdown of protesters to the arrest and imprisonment of opposition leader Leopoldo Lopez, Venezuela continues to be an embarrassment to our hemisphere's democratic sensibilities. I must say, I am extremely disappointed with the Obama administration's lack of leadership all over the world, including right here in our own hemisphere. Every day, we see the results of American disengagement. And of a President more interested in apologizing for our country than defending our values.

The very clear result is that our friends and allies no longer trust us and our adversaries no longer fear us. In the Americas, President Obama's perceived weakness has cleared the way for Russia, China, and Iran to establish economic and diplomatic influence right at our doorstep. This reality should give us all great pause. Just this past week, a Venezuelan general, a close ally of the late President Hugo Chavez, and known associate of FARC narcotics traffickers, was arrested on U.S. drug charges on the Dutch island Aruba. Astonishingly, The Netherlands chose to acquiesce to Venezuelan pressure, releasing General Carvajal to return to Venezuela for a hero's welcome on grounds that he had diplomatic immunity on the island. The sad fact is that U.S. credibility worldwide has been so damaged that a Venezuelan who had been blacklisted by Treasury for aiding FARC terrorists in narco trafficking, was released by our Dutch allies under Venezuelan pressure. Recall that this body passed a Venezuela sanctions bill in May after President Maduro's continued violent aggression and repression of protesters. And we have been pressing the administration to move forward with some form of punitive measure to show the Venezuelan Government and the world that we are not going to stand by as the rights of freedom seekers are trampled by undemocratic dictators.

I was gratified to receive a phone call from Assistant Secretary Jacobson yesterday letting me know that the administration would announce today that visa denials and prohibitions over 20 Venezuelan Government officials complicit in violent repression of protesters in opposition. This action on the part of the administration is so long overdue and merely a step in the right direction. The administration must be unrelenting in reaffirming our commitment to protecting basic democratic rights worldwide.

Blatant disregard for democratic values and the rule of law have affected Argentina's economic outlook. Another country rich in natural resources and human capital, Argentina has been under the stranglehold to the leftist populist policies of Cristina Kirchner and her late husband, Nestor, before her. Plagued by corruption and a stated policy that flouts the rule of law, Argentina is an economic basket case. In fact, unless drastic, last minute measures are taken, Argentina is scheduled to default on billions of dollars to bond holders today. The consequences of a second default in 13 years will be dire for the Argentinian people and their economy.

I am looking forward to hearing witnesses' analysis of this looming default and what long-term impacts will be for Argentina and for the region.

Ecuador poses another challenge in the region. Insulated to some degree by a dollarized economy, Correa's authoritarian approach to both the economy and governance in general places Ecuador among the least democratic nations in the Americas. Arbitrary regulations and media laws that stifled dissent are disappointing, the hallmark of the Andean country. More important, President Correa has consistently coupled his attacks against democracy and free trade with open antipathy to the United States and her interests. Meanwhile, the Obama administration has failed to come up with a strategy to deal with the ALBA bloc countries, Ecuador, Bolivia, Venezuela, Cuba, Nicaragua and encourage more market friendly and democratic values in our region.

It seems clear to me that a commitment to the rule of law coupled with free trade and economic liberty will lead to stronger and more vibrant democracies. We should all be encouraged by the exciting free trade bloc known as the Pacific Alliance, as well as the prospect that energy reforms in Mexico, could bring about greater North American energy independence and security.

The Western Hemisphere is commercially and culturally vibrant and the United States should do more to encourage the opening of markets and opportunity to nations currently strangled by populism. This will do much to empower citizens to make them less dependent on government, thereby making governments less powerful and less authoritarian. But to realize these goals of a more prosperous and free Western Hemisphere, the U.S. has got to do the leading.

As we are seeing around the globe today, the unraveling of U.S. leadership is not just embarrassing, it threatens peace and stability. You cannot turn on the news on any station without seeing our failed leadership completely across the globe. Now it is time to turn the tide and reengage to inspire regional laborers to seek freedom and economic prosperity through open markets that are protected by the rule of law. And I am eager to hear from witnesses about how the United States can work constructively to improve transparency in the rule of law in our hemisphere.

And I would now recognize Mr. Connolly.

Mr. CONNOLLY. Mr. Chairman, thank you, and thank you on behalf of our mutual friend, Albio Sires, who is under the weather and cannot be here. He has asked me to read his statement into the record. If I may, and before I do that, I am taking advantage of your graciousness and hospitality. I could not disagree with you

more and I completely disassociate myself from most of what you just said.

The rhetoric coming out of my friend on the other side of the aisle—

Mr. DUFFY. I am glad the record notes that.

Mr. CONNOLLY. Thank you. I know it will come as a shock to you, but this notion that we are retreating from leadership and oh, my God, any problem in the world is somehow the fault of this President, we might as well blame him for hurricanes in the Caribbean, too. The unraveling if there was such of American leadership traces directly to the cowboy diplomacy, go it alone policies of the previous administration, George W. Bush, who did incalculable damage to the standing of the United States, all over the world.

And I can tell you that someone who has been in foreign policy for a long time, the notion that somehow people are worried about us retreating, they may be worried about whether you are going to stay, but they are not worried about our retreating. In fact, the demands on us continue to grow and that is why things like the Trans-Pacific Partnership are so important and why there is so much excitement about it in the region that once again the United States is exercising leadership and providing a counterbalance with China, but that is just an editorial comment.

Mr. SALMON. That is welcome.

Mr. CONNOLLY. Thank you, Mr. Chairman. I thank you. Now on behalf of Mr. Sires:

“Thank you, Mr. Chairman. This hearing comes at a time when the United States and its closest neighbors face the daunting task of addressing the needs of thousands of Central American child migrants escaping one of the most impoverished and violent regions of the world. Elsewhere, we see the benefits of decades long democratic consolidation and economic prosperity in Brazil, Mexico, and Colombia, for example, alongside political and social unrest in Venezuela, as you said, Mr. Chairman, and economic uncertainty in Argentina.

“We have also borne witness to a dictatorship in Cuba that after 50 years continues to act with impunity restricting basic human rights, freedoms of expression, and economic opportunity. Indeed, the road to democracy in our hemisphere has been long and fraught and challenging. The lack of inclusive participation by all members of society and the growing economic prosperity of the region has made the Americas vulnerable to anti-democratic forces. Additionally, weak state presence and corrupt governance has allowed drug traffickers to act within impunity in many of these countries while economic and fiscal insecurity has hampered sustainable progress and further encouraged immigration abroad. Without a doubt, respect for and application of the rule of law of today is central to the stability and economic prosperity of our neighbors.

“While all nations in the hemisphere other than Cuba are now ruled by elected leaders, democratic progress has been beset by the inability to ensure political accountability, public goods and safety and uphold the rule of law.

In Mexico and Central America, drug-related crime and violence have set back democracy and public security. While in Venezuela, Bolivia, Ecuador, and Nicaragua, elected leaders have abused executive office to consolidate power, limit the rights of freedoms of political dissent, and dismantle institutional checks and balances. We have learned that elections do not make a democracy alone, nor do they guarantee legitimacy. In the same vein, a country's laws mean little if they are arbitrarily imposed, inefficient, corrupt, or unenforced. In part, these points reinforce the importance of the rule of law.

"The rule of law ensures political rights, civil rights, civil liberties, mechanisms of accountability. They, in turn, affirm political equality of citizens and constrain potential abuses of the state. In this fashion, the rule of law works in tandem with other pillars of democracy. Without a robust rule of law, defended by an independent judiciary, rights are not safe, and equality and dignity of all citizens at risk. In fact, for some time now, we have witnessed a breakdown of the judicial system in some countries in the region, whereby Supreme Courts have been dismissed and Judges are being appointed heavily in favor of one party over another.

"With respect to economic prosperity, a rule of law framework that encompasses government effectiveness, regulatory and judicial accountability, and anti-corruption, has been shown to have a significant impact in making countries more attractive to foreign investment. On the one hand, while the rule of law provides the institutional framework to protect basic political and human rights, it also on the other provides the private sector the confidence it needs to operate within a formal economy and contribute to the country's economic growth.

"A business owner or a corporation is more likely to succeed in an environment whereby laws are public, transparent, and applied neutrally without prejudice. Additionally, a rule of law framework that provides clear and consistent legal rules for the formation and preservation of contracts, investments, and settlement disputes, encourages competitiveness and provides assurances to firms that contracts will, in fact, be upheld and honored in a rule of law.

"Whether or not the rule of law is a prerequisite for economic growth or vice versa is maybe a matter of debate. The economic success of China comes to mind in that regard. What is not uncertain is the vital role that the rule of law ultimately plays in fostering sustained economic growth and development.

"I look forward to hearing from our panelists regarding the rule of law in Latin America and how it has impacted economic growth and investor confidence and welcome our witnesses here today. Thank you, Mr. Chairman, for your graciousness."

Mr. SALMON. I thank the gentleman. Pursuant to Committee Rule 7, the members of the subcommittee will be permitted to submit written statements to be included in the official hearing record. Without objection, the hearing record will be open for 7 days to allow statements, questions, and extraneous materials for the record, subject to the length limitation in the rules.

I would like to introduce the panel now. First, we would like to introduce Ambassador Glassman. James K. Glassman served as the U.S. Undersecretary of State for Public Diplomacy and Public Affairs and chairman for the Broadcasting Board of Governors. Currently, he is a Visiting Fellow at the American Enterprise Institute. He holds a B.A. degree from Harvard University.

Mr. Paul Barrett is the author of *Law of the Jungle*. That has got to be about Congress. I feel like I am living in the jungle or a jungle book. A book that describes his findings of the Chevron case in Ecuador and is scheduled to be published in September. He is a graduate of Harvard Law School and is also an adjunct professor at New York University Law School.

And then finally, Mr. Jose Fernandez. Mr. Fernandez is a corporate partner in the New York Office of Gibson, Dunn & Crutcher, and co-chair of the firm's Latin America Practice Group. He served as the Assistant Secretary of State for Economic, Energy and Business Affairs as well as the State Department's principal representative in the Committee on Foreign Investment in the United States. He received his B.A. in History from Dartmouth College and holds a J.D. from Columbia University School of Law.

You all understand the lighting system. It is green for the first 4 minutes and when it turns amber, you have got time to wrap up. And at the end the red light comes on and it is time to be done. After, we are going to have a series of questions for the panelists.

So let us begin. Mr. Glassman, I would like to recognize you first. Thank you.

STATEMENT OF THE HONORABLE JAMES K. GLASSMAN, VISITING FELLOW, AMERICAN ENTERPRISE INSTITUTE (FORMER UNDER SECRETARY FOR PUBLIC DIPLOMACY AND PUBLIC AFFAIRS, U.S. DEPARTMENT OF STATE)

Ambassador GLASSMAN. Thank you, Mr. Chairman, members of the subcommittee. Mr. Chairman, as you said, the recent surge of undocumented children is just the latest reminder of the absolute fact that a stable and prosperous Latin America is critical, not just to Latin Americans themselves, but to all of us here in the United States.

Many Latin American countries have made significant economic progress in recent years, among them, Chile, Colombia, Costa Rica, Uruguay, Peru, and Mexico. But the performance of Bolivia, Ecuador, and lately Brazil is disappointing. Their economies suffer in various degrees from a lack of respect for the rule of law, crucial to attracting the capital investment that fuels growth.

Aside from the sad cases of Cuba and Venezuela, the worst offender in this regard is Argentina. It ranks 166 out of 178 countries on the index of economic freedom. Argentina has abundant natural resources and a workforce that has proven itself in the

past. In 1908, it was the seventh wealthiest country in the world. Today, it is 55th.

This very day, the grace period in Argentina's court-ordered debt repayments runs out and we shall soon know if it has defaulted for the eighth time in its history. But default or not, Argentina has done enormous damage by setting an example for other irresponsible countries to follow. After Argentina missed payments on \$100 billion in bonds in 2001, the country bullied creditors into settling at pennies on the dollar, doctored its economic statistics, expropriated a Spanish energy company, and defied 100 court judgments. Through it all, the U.S. largely stood on the sidelines. Argentina even remains a member of the prestigious G20, the group of nations charged with keeping the world economy stable.

Argentina's success at flouting the financial world order inspired Ecuador which defaulted in 2008 and Belize, which threatened creditors with a restructuring offer even worse than Argentina's. Now, it is the turn of Puerto Rico, a U.S. territory since 1898. Puerto Rico's economy is in shambles. In the eighth year of recession, its workforce has declined by one third. Meanwhile, the island has piled up debt of \$73 billion. If it were a state, Puerto Rico, population 3.7 million would rank behind only California and New York as the third most indebted.

Rather than trying to reform a sick economy with a bloated public sector and high taxes, the Governor of Puerto Rico, Governor Alejandro Padilla has chosen the Argentine way.

On June 25th, apparently preparing for default, Puerto Rico passed a law called the Recovery Act that strips basic rights from creditors who own about one third of the island's bonds, including, I note, many unsuspecting U.S. investors with money in mutual funds, while protecting other bond holders, many of them hedge funds. But this Argentine-style ploy does not seem to be making credit rating agencies wary of what Puerto Rico might do next quickly downgraded both types of bonds well below the threshold of junk status. And now Puerto Rico is facing lawsuits from U.S. investors that could drag on for years.

Also, reminiscent of Argentina is Puerto Rican Government's disregard for the rule of law in dealing with businesses. One visible case involves a bank called Doral which overpaid its taxes a decade ago and then entered into a series of agreements with Puerto Rico's Treasury Department for refunds. Suddenly, in May, the government declared that deal null and void. Rather than imitating Argentina, Puerto Rico needs to cut its budget, reduce taxes, institute economic policies that encourage investment, rescind its Recovery Act, restore the rule of law and negotiate faithfully with creditors.

For the protection of our own taxpayers in the United States who could end up holding the bag, the U.S. should perform a full audit and set up a financial control board with authority over borrowing, hiring, firing, and contracts such as the boards that succeeded in New York and the District of Columbia. If the United States and other countries had been tougher with Argentina, its dangerously seductive model would have been rendered unattractive. Now the U.S. has a chance to rectify matters by guiding Puerto Rico to the prosperity that its people deserve.

Mr. Chairman, when it comes to promoting prosperity and stability in Latin America by encouraging strict adherence to a just legal system, the United States should not stand by. We must take the lead. Our own security and prosperity demand it. Thank you.
[The prepared statement of Ambassador Glassman follows:]

Ambassador James K. Glassman
Visiting Fellow, American Enterprise Institute
Former U.S. Under Secretary of State for Public Diplomacy and Public Affairs

Committee on Foreign Affairs
Subcommittee on the Western Hemisphere

Wednesday, July 30, 2014

A Hearing on
“Building Prosperity in Latin America: Investor Confidence in the Rule of Law”

Mr. Chairman, Members of the Committee:

The surge of undocumented children into the United States in recent months from Honduras, Guatemala, and El Salvador is only the latest reminder of the importance of a stable and prosperous Latin America -- not just to Latin Americans themselves but to all of us here in the United States.

Overall, Latin America has made significant progress over the past three decades toward the kind of free-market economic policies that insure both growth and opportunity at home and robust markets for U.S. businesses. For example, iShares Latin America 40, a popular exchange-traded fund that owns large-capitalization stocks from the region, has produced average annual returns of 16.1 percent over the past 10 years, compared with 8.3 percent for a fund that mimics the U.S. large-cap benchmark.¹ There are, however, major differences among nations, and several have been moving in the precisely the wrong direction.

¹ <http://etfs.morningstar.com/quote?t=ILF®ion=usa&culture=en-US>

For example, the Index of Economic Freedom, published annually by the Wall Street Journal and the Heritage Foundation, ranks Chile seventh among 178 countries on a scale that includes 10 metrics, from property rights to entrepreneurship.² (The U.S. itself ranks 12th.) In South America, Colombia, Uruguay, Peru, and Mexico are all in the top one-third of countries in the index – rankings that reflect major strides toward growth-enhancing policies. Many Caribbean and Central American nations also score well, including Barbados, St. Lucia, and Costa Rica.

It is hardly a surprise that Cuba ranks 177th, just above last-place North Korea, and that Venezuela is number 175, edging out Zimbabwe. But, more alarming has been the decline of Bolivia (158th), Ecuador (159th), and Brazil (114th). While in the recent past, Brazil has been favorably compared to India and China as a fast-growing developing market, Brazilian GDP growth this year is expected to be just 1 percent, compared with 3.2 percent for Chile and 5 percent for Colombia – and 6 percent or more for both India and China.³ A reflection of the lack of investor confidence in Brazil is that the country's 10-year sovereign bonds are yielding 11.7 percent, compared with 6.5 percent for a similar bond issued by Colombia, 7.8 percent for a Mexican government bond, and just 2.7 percent for an Italian bond.⁴

Backsliding Latin American nations suffer from poor governance, especially the lack of adherence to the rule of law. And governance is linked to economic performance. In its 2013 Investment Climate Statement, the U.S. State Department lays out the problem well with respect to Ecuador, whose "investment climate"

**remains uncertain as its economic, commercial and investment policies
continue to change. While some laws and regulations have been enacted to
spur increased domestic and foreign private investment, other legal changes**

² <http://www.heritage.org/index/ranking>

³ <http://www.economist.com/news/economic-and-financial-indicators/21608783-output-prices-and-jobs>

⁴ <http://www.economist.com/news/economic-and-financial-indicators/21608780-trade-exchange-rates-budget-balances-and-interest-rates>

have reduced private sector participation in so-called strategic sectors, most notably extractive industries, and negatively affected banking and media sectors. Frequent changes in Ecuador's tax code make business planning difficult.... In general, the legal complexity resulting from the inconsistent application and interpretation of existing laws complicates enforcement of contracts and increases the risks and costs of doing business in Ecuador. According to the National Development Plan ("Plan Nacional el Buen Vivir"), economic growth is not an end in itself and economic development is led by the state. Private investment, therefore, does not constitute a policy priority.⁵

Even more alarming, however, is Argentina, which ranks 166th on the Index of Economic Freedom, behind such exemplars as the Central African Republic and Uzbekistan. Argentina has abundant natural resources, European-style sophistication, and a workforce that has proven itself in the past. Between 1871 and 1914, Argentina's average annual growth rate was the fastest in the world, at 6 percent.⁶ In 1908, it was the seventh-wealthiest country in the world; today, it is 55th.⁷ Argentina is a sad case – and a shining example of why good public policies, including strong rule of law, matter.

With a population of 41 million, Argentina is the fourth-largest Latin American country, behind Brazil, Mexico, and Colombia. The danger is that its influence outweighs its size. This hearing addresses "investor confidence in the rule of law." Argentina's actions in defiance of the rule of law since its \$100 billion debt default in 2001 – the largest, at the time, in history – have not merely shaken investor confidence in Argentina, but also have served as a model for other governments to emulate.

⁵ <http://www.state.gov/e/eb/rls/othr/ics/2013/204634.htm>

⁶ <http://www.economist.com/news/briefing/21596582-one-hundred-years-ago-argentina-was-future-what-went-wrong-century-decline>

⁷ <http://www.bloomberg.com/news/2014-02-03/argentina-bust-lures-bass-led-investors-in-200-years-of-defaults.html>

That Argentine model can be described very simply: flout international financial standards, refuse to follow court rulings, and vilify creditors. In late 2008, Ecuador defaulted after Rafael Correa was elected president on a platform of debt repudiation.⁸ In 2012, Belize, also following the Argentine script, threatened a default on a "restructuring offer that was worse than what Argentina gave creditors following its 2001 default."⁹ In the end, Belize came to its senses.

Now, we are seeing the Argentine disease infect Puerto Rico, a government intimately tied to the United States. My testimony elaborates on the lessons of the Argentina default and explores the dangers of the situation in Puerto Rico. I conclude with some recommendations to policy makers on how to deal with growing attacks on investor confidence in our hemisphere.

The Argentine Model

On the very day of this hearing, July 30, 2014, the grace period for Argentina to comply with U.S. courts and make payments to creditors will run out. Barring an unexpected turn of events, Argentina will either make good on what it owes or suffer its eighth default since becoming an independent nation in 1816.¹⁰

Argentina finds itself in this predicament through its own poor decisions and a rogue approach to its obligations. Rather than cooperating with international financial institutions and the courts to restructure its debt, its leadership, under President Cristina Fernandez de Kirchner, chose a route of defiance – which played well temporarily at home but led to a end to private credit from abroad and, now, economic stagnation. Argentina's GDP is forecast to decline 1.2 percent this year,

⁸ <http://blogs.reuters.com/felix-salmon/2009/05/29/lessons-from-ecuadors-bond-default/>

⁹ <http://www.bloomberg.com/news/2013-01-14/belize-rejecting-argentine-default-model-spurs-region-best-rally.html>

¹⁰ <http://www.bloomberg.com/news/2014-02-03/argentina-bust-lures-bass-led-investors-in-200-years-of-defaults.html>

and its inflation rate, according to the State Street PriceStats Inflation Index, is 42 percent.¹¹ Argentina managed, over much of the last decade, to keep its economy going through the sale of agricultural commodities, like soybeans and corn, and through import and export restrictions, but those makeshift remedies have clearly failed.

After the 2001 default, Argentina gave its creditors – including foreign governments, institutional investors, and individuals – a take-it-or-leave-it 25 cents on the dollar, far below a conventional settlement offer. Many of those owed money, including 60,000 Italian pensioners, refused the deal. About three-quarters of creditors accepted, but there were far more holdouts than in a typical restructuring. The holdout creditors had some strong protections on their side.¹²

Because of its history of defaults, Argentina was only able to raise debt in the 1990s by agreeing to a waiver of sovereign immunity, a pledge to adjudicate matters in New York courts, and a *pari passu* clause that required the borrower to place creditors on an equal footing. Partly as a result, the holdout creditors won more than 100 court judgments, but Argentina refused to honor the rulings. On Oct. 26, 2012, a federal appeals court panel upheld a district court ruling that Argentina could not repudiate its obligations to holdouts and had to treat holders of all its debt equally. U.S. District Court Judge Thomas Griesa stated: “There cannot be a payment to the exchange bondholders [settled creditors] without court-ordered payments to the plaintiffs [holdout creditors].”

Argentina tried but failed to get the U.S. Supreme Court to overturn the lower court rulings, all the while mocking and criticizing the U.S. legal system. In February 2013, for example, Jonathan Blackman, a lawyer for Argentina, said to U.S. Circuit Judge

¹¹ The inflation rate that the Argentine government reports has “not yet proven to be reliable,” according to the Economist magazine: <http://www.economist.com/news/economic-and-financial-indicators/21608783-output-prices-and-jobs>

¹² <http://online.wsj.com/news/articles/SB10001424127887324660404578197912267848812>

Reena Raggi: "We are representing a government, and governments will not be told to do things that fundamentally violate their principles."

"So," said Judge Raggi, "the answer is you will not obey any order but the one you propose?"

"We would not voluntarily obey such an order," Blackman said.¹³

President Fernandez echoed these sentiments last months: "What I cannot do as president is submit the country to such extortion," she said last month."¹⁴

But Argentina's defiance would not have been nearly so effective in delaying the day of reckoning if the official international financial community had not displayed so much tolerance, even encouragement, of its antics. The International Monetary Fund, for example, censured Argentina for doctoring its economic statistics but took no more significant action. Argentina refused to abide by the rulings of the World Bank's International Centre for the Settlement of Investment Disputes, with no consequences.¹⁵ In 2011, to its credit, the U.S. adopted a policy of declining to vote yes on multilateral development bank loans to Argentina, but few countries followed its lead. And earlier this year, the Club of Paris, some 13 years after Argentina's default, agreed to a settlement of \$10 billion in debt to such governments as Japan, Germany, and the United States, but acceded to Argentina's demand that, contrary to past practice, there would be no oversight by the IMF. The Club of Paris meekly went along.¹⁶ On top of this defiance, Argentina nearly three years ago expropriated the majority interest that Repsol, a large Spanish company,

¹³ <http://www.businessweek.com/news/2013-02-26/argentina-seeks-relief-from-u-dot-s-dot-court-in-debt-fight> and <http://www.finalalternatives.com/node/22998>

¹⁴ <http://www.foxnews.com/politics/2014/06/17/argentina-president-defies-us-court-orders-on-repayment-debts/>

¹⁵ <http://www.reuters.com/article/2012/03/26/us-usa-argentina-trade-idUSBRE82P0QX20120326>

¹⁶ <http://online.wsj.com/articles/james-k-glassman-dont-welch-on-me-argentina-1401826159>

held in the Argentine energy firm YPF.¹⁷ In February, Argentina agreed to pay Repsol \$5 billion for the seized stock – about half what it was worth

Perhaps worst of all, Argentina remains a member of the most exclusive economic club in the world, the Group of 20. Founded 15 years ago in response to the Asian financial crisis, the G20 was meant to consist of 20 large, systemically important economies. It was only in 2008, after President George W. Bush called its heads of government together in the wake of a far more serious crisis that the G20 rose to prominence, and it adopted the role of relieving that crisis and establishing standards to promote growth and prevent another catastrophe.

The G20 never had criteria for members. It was merely the G7 (U.S., U.K., Germany, France, Italy, Canada, and Japan) plus the European Union as a separate member, China, and 11 others, chosen by the original group. For reasons that defy logic, Argentina was one of those selected. In June 2012, Alex Brill of the American Enterprise Institute and I published a study that looked at this question: If the G20 members *were* chosen by objective criteria, what would those metrics be, and which countries would be chosen? Our study examined such data as GDP, extent of exports, systemic financial connections, and rule of law.¹⁸ For the last set of measurements, we relied on three of the World Bank's Governance Indicators: "control of corruption," "regulatory quality," and "rule of law."¹⁹

We concluded that four of the 20 countries did not qualify, but of those four, Argentina was by far the most glaring case. Among the 20, Argentina ranked last in size, last in financial interconnectedness with the rest of the world, and fourth from the bottom in rule of law. Recent rule of law data from the World Bank are worse. Argentina now ranks below the 20th percentile,²⁰ that is, among the bottom one-fifth

¹⁷ <http://www.reuters.com/article/2014/02/25/us-repsol-argentina-idUSBREA1011J20140225>

¹⁸ http://www.aei.org/files/2012/06/14/-brill-g20-ntu-paper_095940274931.pdf

¹⁹ <http://info.worldbank.org/governance/wgi/index.aspx#home>

²⁰ *Ibid.*

of all countries. In addition, Argentina ranked last among the 20 in compliance with the priority commitments that members made at the 2010 Seoul Summit.²¹

Argentina never should have been a member of the G20 in the first place, but the United States and other G20 have had a golden opportunity to use the threat of expulsion as a incentive for Argentina to comply with its international commitments. Sen. Richard Lugar, who has since retired, introduced a resolution in Congress in 2012 to suspend Argentina's G20 membership because of its activities involving default, but no action was taken.²²

Now there are signs that the Argentine model of rogue behavior has attracted the attention of a U.S. territory, Puerto Rico. It is hard to overstate the danger if Puerto Rico decides to become another Argentina. Not only will the territory's economy suffer, but, in the end, not only U.S. investors but also U.S. taxpayers would be left holding the bag.

The Travails of Puerto Rico

The United States acquired the island of Puerto Rico as a result of the Spanish-American War of 1898. Its inhabitants, who now number 3.7 million, enjoy many of the benefits of being full-fledged U.S. citizens, including Social Security and Medicare. Interest on Puerto Rico's municipal bonds is exempt from U.S. taxes on a federal, state, and local basis, and, until lately, there has been a ready market for buying Puerto Rican debt.

Puerto Rico's economy is a shambles. It is now in the eighth year of recession. Its closely watched Economic Activity Index has plunged from 155 in January 2007 to

²¹ www.g20.utoronto.ca/compliance/2010seoul-final/index.html

²² "A Resolution Expressing the Sense of Congress That the Republic of Argentina's Membership in the G20 Should Be Conditioned on Its Adherence to International Norms of Economic Relations and Commitment to the Rule of Law," Senate Resolution 457, 112th Congress, 2d Session, May 10, 2012.

128 in May 2014,²³ unemployment is 13.1 percent,²⁴ and the labor-force participation rate is a mere 41 percent.²⁵ In 2007, nearly 1.3 Puerto Ricans had jobs; today, fewer than 1 million do. Residents are abandoning the island at a rate of 100 a day.

What makes matters worse is that Puerto Rico has total public sector debt of \$73 billion.²⁶ The Wall Street Journal called that figure “gigantic compared with the roughly \$18 billion owed by Detroit when it filed in July [2013] for the largest municipal bankruptcy in U.S. history.”²⁷ If Puerto Rico were a state, it would rank behind only California and New York as the third most indebted, “despite a smaller and poorer population.”²⁸ A study by Nuveen, the bond house, points out that net tax-supported debt as a percentage of personal income is 88 percent in Puerto Rico, compared with less than 11 percent in Hawaii, which is the highest among all 50 states.²⁹

Puerto Rico not only has a large debt, it also has payments coming due. For example, “within the next 30 days,” writes Reid Wilson of the Washington Post, “the Puerto Rico Electric Power Authority (PREPA) will have to pay back more than \$650 million to two big banks.”³⁰ PREPA is one of Puerto Rico’s “public corporations,” government-run companies created seven decades ago. PREPA’s debt load is \$9.3 billion,³¹ and it is only one of many government entities on the island whose debt service is in jeopardy.

²³ <http://www.gdbpr.com/documents/2014-04MayGDBEconomicActivityIndex.pdf>

²⁴ <http://www.bls.gov/eag/eag.pr.htm>

²⁵ <http://www.economist.com/news/finance-and-economics/21588364-heavily-indebted-island-weighs-america-municipal-bond-market-puerto-pobre>

²⁶ <http://www.noticel.com/uploads/gallery/documents/275643203a526da79d9252aedffde414.pdf>

²⁷ <http://online.wsj.com/news/articles/SB10001424052702304441404579119251798925192>

²⁸ <http://www.economist.com/news/finance-and-economics/21588364-heavily-indebted-island-weighs-america-municipal-bond-market-puerto-pobre>

²⁹ <http://www.nuveen.com/Home/Documents/Viewer.aspx?fileId=63250>

³⁰ <http://www.washingtonpost.com/blogs/govbeat/wp/2014/07/24/looming-puerto-rico-debt-deadlines-have-investors-nervous/>

³¹ <http://www.noticel.com/uploads/gallery/documents/275643203a526da79d9252aedffde414.pdf>

Heavy debt is a function both of the ease of borrowing and of mismanagement of the Puerto Rican economy. The best course of action for Puerto Rico would be to reduce its bloated public sector (which accounts for more than 20 percent of the workforce³²) and enact the kind of free-market policies and strict rule of law that have helped other small nations, such as Singapore, to thrive. As Thomas Weyl of Barclays, one of the best-informed analysts of Puerto Rico, wrote last month: "Absent economic progress, which is not currently visible, it is only a matter of time before the debt load becomes unsustainable."³³

Rather than economic progress, Puerto Rico has chosen a course pioneered by Argentina. On June 25, the administration of Governor Alejandro Garcia Padilla introduced the Puerto Rico Public Corporations Debt Enforcement and Recovery Act (Recovery Act), and within just three days it was passed by the Senate and House and signed into law. The Recovery Act sets a legal framework for restructuring much of Puerto Rico's debt. Specifically, it calls for creditors to reach a consensual agreement among themselves without the courts. "After 50 percent of creditors vote and 75 percent of those voting (by amount outstanding) agree to a plan, it will then go before a judge for approval."³⁴ This alternative effectively strips creditors of their rights. A group of them representing just three-eighths of the total debt can determine the grounds for a settlement. If creditors are unable to reach an agreement themselves, then a court-ordered bankruptcy process kicks in. In short, the Recovery Act is an after-the-fact measure that gives Puerto Rico's government inordinate power to decide who gets paid, how much, and when.

The Recovery Act applies only to bonds issued by PREPA as well as Puerto Rico's public corporations concerned with highways, sewer and water, and public buildings. The four bond-issuing authorities have about \$25 billion in debt

³² <http://www.economist.com/news/finance-and-economics/21588364-heavily-indebted-island-weighs-america-municipal-bond-market-puerto-pobre>

³³ Thomas Weyl, Sarah Xue, and Ming Zhang, Barclays Municipal Research, "Implications of Puerto Rico's Recovery Act," June 27, 2014.

³⁴ Ibid.

outstanding, according to the latest official quarterly report of Puerto Rico's finances³⁵ -- or more than one-third of the total for the territory. These corporations have consistently run deficits, which have been funded by other Puerto Rican government entities, such as the Government Development Bank. They are poorly run, and there is no reason to believe they will suddenly become profitable or solvent. (A majority of the electric power on the island, for instance, is generated by PREPA from expensive oil.)

A recent Nuveen report on the Recovery Act was headlined, "Puerto Rico Reaches the Limit of Its Ability to Pay,"³⁶ and there is little doubt that the Act was meant to set the stage for restructuring a large chunk of the territory's debt in ways that will cause pain to creditors. The fact that the majority of debt -- including that of the Puerto Rico Sales Taxes Financing Corp. (COFINA) and the general obligation bonds of the Commonwealth of Puerto Rico itself -- were listed as exempt from the Recovery Act is hardly a reassurance to these other creditors. While this debt appears to be "roped off," the level of trust is not high for a government that would swiftly pass an Argentina-style Recovery Act without consultation with creditors. The group of exempt bond may simply be the next target of legislation. It is worth quoting the Nuveen report at length:

While introducing the legislation, Governor Alejandro Garcia Padilla repeatedly stressed that the Commonwealth of Puerto Rico intends to honor the obligations of the central government, namely general obligation, sales tax backed and appropriation debt. We note that Gov. Padilla and his predecessors previously made similar assertions about all of Puerto Rico's obligations, and therefore we take little comfort in such claims today.

By instituting legislation to restructure the debt of the public corporations -- all of which are instrumentalities of the Commonwealth -- Puerto Rico is clearly demonstrating that there is a limit to its willingness to pay its

³⁵ <http://www.noticel.com/uploads/gallery/documents/275643203a526da79d9252aedffde414.pdf>

³⁶ <http://www.nuveen.com/Home/Documents/Viewer.aspx?fileId=63194>

obligations. The government is effectively saying it is no longer willing to pay back loans used to build Puerto Rico's essential transportation, power, and water and sewer infrastructure, in full or on time. Barring a significant and lasting reversal in Puerto Rico's economic trajectory, we believe the Commonwealth will continue to struggle with budget deficits and may ultimately enact similar restructuring measures for its general obligation debt.³⁷

If the Recovery Act was meant to condemn some bonds while assuring the protection of others, it failed. Within days, the U.S. bond ratings agencies cut the ratings of PREPA and the other public corporations. Moody's, for example, demoted PREPA from Baa2 to Caa3, to "speculative of poor standing and...subject to very high credit risk."³⁸ That was no surprise. But the credit agencies also downgraded the bonds that the Recovery Act was supposed to protect. Puerto Rico's general obligation bonds, for instance, were slashed by Moody's from B2 to Ba2,³⁹ defined as "speculative and...subject to substantial credit risk."

Moody's clearly did not buy the distinction that the Padilla administration was trying to make. In the report that accompanied the downgrades, the agency stated:

By providing for defaults by certain issuers that the central government has long supported, Puerto Rico's new law marks the end of the commonwealth's long history of taking actions needed to support its debt. It signals a depleted capacity for revenue increases and austerity measures and a new preference for shifting fiscal pressures to creditors, which, in our view, has implications for all of Puerto Rico's debt, including that of the central government.⁴⁰

Padilla's response to the Moody's downgrades was to threaten the credit agencies with lawsuits. "I have instructed the Attorney General to assert the truth and clear

³⁷ Ibid.

³⁸ <http://online.barrons.com/news/articles/SB50001424053111904248904580003610191234810>

³⁹ https://www.moody.com/researchdocumentcontentpage.aspx?docid=PBC_79004

⁴⁰ <http://online.barrons.com/news/articles/SB50001424053111904248904580003610191234810>

the good name of Puerto Rico,” he said, in a statement similar to those of President Fernandez of Argentina. “That credit agency, and any other entity acting alike, will have to answer for this offense.”⁴¹

On June 28, the day the Recovery Act was signed, Oppenheimer and Franklin Templeton, two asset management firms that own a total of \$1.7 billion worth of Puerto Rican bonds of many varieties, filed a lawsuit in the U.S. District Court of Puerto Rico, alleging that the Act violates provisions of the U.S. Constitution. The argues that the Act deals with bankruptcy matters but, according to the U.S. Constitution, only the U.S. Congress can determine such issues under the “bankruptcy clause.”⁴² BlueMountain Capital Management, a hedge fund that owns \$400 million in debt and is represented by Ted Olson, the former U.S. solicitor general, has also challenged the Recovery Act in court.⁴³

Meanwhile, according to a July 17 statement, a group of 18 hedge funds said that it “stands behind the efforts of the governor and the commonwealth to enact legislation to substantially eliminate budget deficits and address the financial and operational difficulties facing certain non-guaranteed public corporations.”⁴⁴ The hedge funds that back the Recovery Act bought up most of the island’s most recent general obligation issue, \$3.5 billion of debt sold in March. The price of that debt dropped sharply after the Recovery Act was announced, down 3 points to 85.5, compared with 93 when the bonds were released.⁴⁵

In many ways, the Puerto Rican situation is developing along Argentine lines, including the high-handed way the government has laid the groundwork for a debt restructuring, the possibility of a long and bloody legal challenge, and the presence

⁴¹ <http://mobile.bloomberg.com/news/2014-07-02/puerto-rico-s-downgrade-shows-debt-law-can-t-contain-rot.html>

⁴² <http://www.noticel.com/uploads/gallery/documents/275643203a526da79d9252aedffde414.pdf>

⁴³ <http://www.reuters.com/article/2014/07/23/usa-puertorico-bluemountain-idUSL2N0PY28Z20140723>

⁴⁴ <http://mobile.bloomberg.com/news/2014-07-25/hedge-fund-pool-supporting-puerto-rico-legislation-adds-14-firms.html#disqus-tab>

⁴⁵ <http://online.barrons.com/news/articles/SB50001424053111904248904580003610191234810>

of so many U.S. hedge funds in the battle. Also reminiscent of Argentina is the Puerto Rican government's disregard for the rule of law in dealing with local businesses, with the effect of discouraging investment on the island.

The most visible case involves Doral Financial Corporation.⁴⁶ Founded in 1972, it grew from a small mortgage company to the island's largest residential lender with about \$8 billion in assets, with 22 branches in Puerto Rico and eight in New York and Florida. A decade ago, Doral made a substantial overpayment of its taxes. Over seven years, Puerto Rico's Treasury Department and Doral entered into a series of agreements about the size of a refund and the timing. Doral still is owed \$230 million, but on May 16, the government suddenly declared its longstanding refund agreement null and void.

In repudiating its debt to Doral, Puerto Rico is sending the worst possible message to other businesses. Who would want to invest in a territory whose government refuses to pay what it owes? "It is not an option for the government of Puerto Rico to issue that refund," said economist Robert Shapiro, a former top official in the Clinton administration. "They are legally, politically, and morally obliged to do so." Shapiro added, in a telephone media conference in May: "By refusing to honor its obligations, the Puerto Rican government joins such deadbeat sovereigns as Argentina, which will measurably reduce the flow of direct investments to Puerto Rico."⁴⁷

The Doral case may also be a factor in a distressing report by Reuters: that Puerto Rico's tax collections are running 27 percent behind budget, with nearly all of the shortfall coming from corporate income taxes.⁴⁸ What company would want to

⁴⁶ <http://www.aei.org/article/economics/fiscal-policy/absent-major-changes-puerto-rico-faces-a-fiscal-calamity/>

⁴⁷ <http://www.aei.org/article/economics/fiscal-policy/absent-major-changes-puerto-rico-faces-a-fiscal-calamity/>

⁴⁸ <http://blogs.reuters.com/muniland/2014/05/12/puerto-rico-stumbles-on-tax-collections/>

overpay the government in light of Doral? Better to underpay and have the government fight for the money.

Recommendations for U.S. Policy Makers

What makes Puerto Rico more ominous for the United States than Argentina is that our own taxpayers could be left with the obligation. Imagine, for example, what would happen if the island defaults, PREPA fails, and the lights begin to go out. Nor can Puerto Rico, because it is not an independent nation, avail itself of such institutions as the IMF. As a U.S. territory (called a “commonwealth” in this case), Puerto Rico’s legal status is ambiguous when it comes to responsibility for debt. But it is clear that the U.S. cannot simply walk away from Puerto Rico’s financial troubles.

One possibility is a federally appointed financial control board, akin to the one that ran the affairs of the District of Columbia from 1995 to 2001.⁴⁹ The board -- established by Congress, with a bill signed by President Clinton -- was similar to the one set up in New York in 1975 and terminated in 1986. The DC board, chaired by Constance Berry Newman, former director of the U.S. Office of Personnel Management, and then by Alice Rivlin, former vice chair of the Federal Reserve and director of the U.S. Office of Management and Budget, had “vast authority over municipal spending, financial planning, borrowing, hiring and contracts.”⁵⁰ Such a board would be well advised not only to pare the island’s bureaucracy but also to rescind the Recovery Act, negotiate with borrowers, and settle differences with Doral and others with valid claims.

U.S. law does not provide for the bankruptcy of states,⁵¹ and Puerto Rico, as a territory, is closer to a state than to any other U.S. entity. But Chapter 9 bankruptcy,

⁴⁹ <http://www.washingtonpost.com/wp-dyn/content/article/2011/01/30/AR2011013003901.html>

⁵⁰ <http://www.nytimes.com/1995/04/08/us/congress-creates-board-to-oversee-washington-dc.html>

⁵¹ http://www.nytimes.com/2011/01/21/business/economy/21bankruptcy.html?pagewanted=all&_r=0

which applies to cities and municipal agencies, could be adapted by Congress to Puerto Rico and provide a far better basis for an orderly disposition of assets in the case of default than the island's home-grown, quickly passed Recovery Act remedy.

Also ominous is that Puerto Rican bonds are widely held by small U.S. investors – many of whom have no idea they own this risky debt. Because Puerto Rican bonds are triple tax-free, they leaven many bond funds marketed to residents of specific states. For example, the top holding of the Oppenheimer Rochester Maryland Municipal bond fund is a Puerto Rican COFINA (sales tax) series, which represents a whopping 8.7 percent of the fund's holdings as of the most recent reporting period, ending May 31. The fund also owns several Puerto Rican public corporation series, including bonds of PREPA, the Public Buildings Authority and the water and highways boards. Overall, roughly one-fourth of the assets of this ostensible *Maryland* muni fund consist of bonds issued by Puerto Rico.⁵² Similarly, an Arizona muni fund managed by Oppenheimer has at least 10 percent of its assets, including its top holding, in Puerto Rican bonds.⁵³

More careful monitoring of Puerto Rico's economy and finances may have prevented the current crisis, but the U.S. government's ambivalent, and often negligent, attitude toward Argentina exacerbated that situation and gave Governor Padilla a profitable model to emulate. The U.S. could at least have threatened to remove Argentina from the G20 and could have insisted that the Club of Rome show some backbone. The Secretary of the Treasury could have used his bully pulpit to condemn Argentina's flouting of the U.S. courts and the World Bank. With strong U.S. encouragement, the IMF could have taken serious action against Argentina – including expulsion -- for falsifying its inflation statistics. Instead, the U.S. – and, worse, nations like France, whose government officials worried about expropriations by Argentina of their own industries – responded to the Argentine challenge with confusion and weakness.

⁵² <http://portfolios.morningstar.com/fund/holdings?t=ORMDX®ion=usa&culture=en-US>

⁵³ <http://portfolios.morningstar.com/fund/holdings?t=ORAZX>

Arnold Kling and Nick Schulz stress in their 2011 book, *Invisible Wealth: Hidden Story of How Markets Work*, that "intangible assets" are vital to the global economy. The most important of those assets is adherence to the rule of law. Investors need certainty that a nation where they commit their money has a legal system that is sound, that laws are enforced, and that important standards don't change in the dead of night. Absent those assurances, investors will either refuse to invest, or will demand a high return if they do. The cost of capital for countries that flout the rule of law will rise, and, as a result, their economies will sputter. "Both policy makers and the research community agree that governance is the key to entrepreneurial decisions that underlie growth," says a World Bank report.⁵⁴

The United States has an enormous stake in countries like Bolivia, Ecuador, Venezuela, and, yes, Argentina, getting back on the track of strong growth and the social stability it brings. Policy makers need to condemn corruption, the destruction of property rights, and failure to abide by the rule of law. But they must also reward nations that are moving in the right direction. A good example is Mexico, which, under its new president, Enrique Pena Nieto, is reforming many sectors of the economy, including energy, by ending price controls and subsidies and opening them up to new investment from abroad. Unfortunately, Mexican industries, such as sugar and steel, are now beset by anti-dumping actions from their U.S. competitors that violate the spirit of the North American Free Trade Agreement. Our officials should be promoting free trade with Latin America, not deterring it.

In addition to trade, U.S. policy makers should support innovations to attract foreign capital investment, even in countries that otherwise present difficult environments. An example is Honduras, where last year a constitutional reform allowed the creation of "semi-autonomous zones with distinct legal, economic, administration,

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<http://econ.worldbank.org/WBSITE/EXTERNAL/EXTDEC/EXTRESEARCH/0,,contentMDK:22451020~pagePK:64165401~piPK:64165026~theSitePK:469382,00.html>

and political (LEAP) protections for job creators.”⁵⁵ These zones are modeled on the successes of Singapore, Dubai, and Hong Kong. The South Korean government has donated a \$4 million feasibility and master plan for a zone near the Gulf of Fonseca, according to a recent article in *National Review* by John Fund, who notes that “China’s special economic zone of Shenzhen started with 30,000 people in the 1990s and now has 11 million who call it home and earn middle-class incomes.” The U.S. should follow South Korea’s lead. Good policies matter.

Mr. Chairman, in a tumultuous world, our government often cannot affect the course of events. But, when it comes to promoting prosperity and stability in Latin America by encouraging free-market policies and strict adherence to a just legal system, the United States should not stand by. We must take the lead. Our history and our destiny demand it.

⁵⁵ <http://www.nationalreview.com/article/383899/honduras-says-yes-leap-zones-john-fund>

Mr. SALMON. Thank you, Mr. Glassman. And now I turn to our next witness, Mr. Barrett.

STATEMENT OF MR. PAUL M. BARRETT, AUTHOR

Mr. BARRETT. Thank you, Mr. Chairman. Thank you for your interest in my forthcoming book, *Law of the Jungle*, which describes the epic legal war over oil pollution in the rain forest in Ecuador. The events I have reported on for the past 3½ years raise troubling questions about the rule of law in Ecuador. These events deserve your attention not only because of the threat they suggest to investor confidence in that country, but also the dangers they pose to the health and welfare of Ecuador's citizens.

Portrayals of this controversy typically resemble a morality play or a fable: Indigenous tribe members fighting an evil, all powerful American oil company. A passive Latin American nation exploited by a mighty, industrial menace. David versus Goliath.

In fact, the story is more complicated, as suggested by two clashing judgments from the Ecuadorian and American court systems. In February 2011, an Ecuadorian judge in the small city of Lago Agrio ruled that Chevron Corporation bears responsibility for severe environmental damage dating to the 1970s. The judge imposed an historic \$19 billion verdict against the company. Three years later, in response to a civil racketeering suit filed by Chevron, a Federal judge in New York ruled that the Ecuadorian judgment was a complete fraud: The culmination of an elaborate extortion scheme orchestrated by an American plaintiffs' attorney and aided and abetted by corrupt Ecuadorian lawyers and judicial officials.

To understand the Chevron case, it is best to begin at the beginning. In the 1960s, Ecuador sought outside investment to take advantage of oil reserves in the Amazon region east of the Andes. Texaco, later acquired by Chevron, signed a series of agreements with the Ecuadorian Government resulting in production and export of oil via a pipeline over the Andes. The oil industry became the backbone of the Ecuadorian economy, raising the aggregate standard of living and contributing to improved social conditions as measured by such markers as decreased infant mortality and increased life expectancy.

Unfortunately, while Ecuador became wealthier overall, economic inequality worsened. And people living near oil operations suffered from the side effects of unregulated industrial activity.

Texaco, it should be emphasized, could have done a much better job of protecting the environment. It dug hundreds of unlined, open-air waste oil pits. It discharged into rain forest streams and rivers billions of gallons of tainted water. Texaco considered but rejected spending modest sums to reduce ecological harm.

The human toll from Texaco's pollution was exacerbated, however, by Ecuadorian Government policies. While some of the rain forest residents affected by the contamination were members of tribes indigenous to the region, far more were farmers encouraged by the Government to move to the oil region under an official policy known as "colonization."

Both Ecuador and Texaco profited from oil production. Some 90 percent of the roughly \$25 billion produced by oil activities in the 1970s and 1980s remained in Ecuador.

In the early 1990s, the Ecuadorian Government nationalized its oil industry and sent Texaco packing. Back in the United States, Texaco faced an unfriendly “welcome home.” A group of American plaintiffs’ attorneys filed a class-action suit in New York in 1993, accusing the company of environmental negligence. The courtroom war had begun.

In Ecuador, Texaco negotiated a cleanup plan with the government under which Texaco assumed responsibility for “remediating” one third of an agreed-upon list of contaminated sites. Ecuador took responsibility for the rest and gave the company a formal release from further liability. Three years later, right around the time Chevron was acquiring Texaco, the Federal courts in New York sided with the oil companies and told the plaintiffs, in essence, take your complaints to Ecuador.

Chevron then learned the wisdom of the old adage “be careful what you wish for.” Sure enough, the lawsuit against Chevron restarted in the provincial courthouse in Lago Agrio in 2003. Both sides employed tactics that would not pass muster in the United States. The plaintiffs’ team, now headed by a brash, New York attorney named Steven Donziger, however, thoroughly outflanked Chevron when it came to unconventional legal tactics. Donziger caajoled and bullied Ecuadorian judges in private meetings and communications. He manipulated a supposedly neutral court-appointed expert, going so far as to arrange for the secret ghostwriting of the expert’s submissions to the court.

Ultimately, according to the March 4, 2014 opinion of U.S. District Judge Lewis Kaplin, Donziger’s team “wrote the Lago Agrio court’s judgment themselves and promised \$500,000 to the Ecuadorian judge to rule in their favor and signed the judgment.” Donziger received ample cooperation from Ecuadorian judges eager to sell their influence to the highest bidder. Four out of the six judges who at one time or another presided over the Lago Agrio case were removed from office for misconduct during the course of that case. The course of this lawsuit in Ecuador and the litigation that underlay the \$19 billion verdict which is now being contested, was shot through with fraud and raised very serious questions about whether the Ecuadorian courts can handle a case like this and I would be pleased to answer more specific questions if you have them.

[The prepared statement of Mr. Barrett follows:]

PAUL M. BARRETT

Author

LAW OF THE JUNGLE:

**The \$19 Billion Legal Battle Over Oil in the Rain Forest
And the Lawyer Who'd Stop at Nothing to Win**
(Crown/Random House, September 2014)

**House Committee on Foreign Affairs
Subcommittee on the Western Hemisphere
Rep. Matt Salmon (R-AZ), Chairman**

Wednesday, July 30, 2014
2:00 p.m.

"Building Prosperity in Latin America: Investor Confidence in the Rule of Law"

Mr. Chairman, Ranking Member, and Members of the Committee:

Thank you for the invitation to testify today. I am grateful for the Committee's interest in my forthcoming book, **LAW OF THE JUNGLE**, which describes the epic legal war over oil pollution in the rain forest in Ecuador. The events I've reported on for the past three-and-a-half years raise troubling questions about the rule of law in Ecuador. These events deserve your attention not only because of the threat they suggest to investor confidence in that country, but also the dangers they pose to the health and welfare of Ecuador's citizens.

I'm here today in a personal capacity as an author and journalist. The best way I can be of use, I believe, is to summarize the story recounted in my book and answer your questions.

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Portrayals of the environmental controversy in northeastern Ecuador typically resemble a morality play or fable: Indigenous tribe members fighting an evil, all-powerful American oil company. A passive Latin American nation exploited by a mighty industrial menace. David versus Goliath.

In fact, the story is more complicated, as suggested by two clashing judgments from the Ecuadorian and American court systems. In February 2011, an Ecuadorian trial judge in the small city of Lago Agrio ruled that Chevron Corporation bears responsibility for severe environmental damage dating to the 1970s. The judge imposed an historic \$19 billion verdict against the company. Three years later, in response to a civil racketeering suit filed by Chevron, a federal judge in New York ruled that the Ecuadorian judgment was a complete fraud: the culmination of an elaborate extortion scheme orchestrated by an American plaintiffs' attorney and aided and abetted by corrupt Ecuadorian lawyers and judicial officials.

These irreconcilable judgments are now being contested in the courts of the United States, Canada, Argentina, and Brazil. Chevron, meanwhile, is pursuing an arbitration action against the

Quito government under the U.S.-Ecuadorian Bilateral Investment Treaty. The arbitration raises the question of whether it's possible for an American corporation to achieve due process in Ecuador's courts.

To understand the Chevron case, it's best to begin at the beginning. In the 1960s, Ecuador sought outside investment to take advantage of oil reserves in the Amazon region east of the Andes. Texaco (later acquired by Chevron) signed a series of agreements with the Ecuadorian government resulting in drilling, production, and export of oil via a pipeline built over the Andes to a port on the Pacific. The oil industry became the backbone of the Ecuadorian economy, raising the aggregate standard of living and contributing to improved social conditions as measured by such markers as decreased infant mortality and increased life expectancy.

Unfortunately, while Ecuador became wealthier overall, economic inequality worsened. And people living near oil operations in the expanding industrial zone in the rain forest suffered from the side effects of unregulated industrial activity.

Texaco could have done a much better job of protecting the environment. It dug hundreds of unlined, open-air waste oil pits. It discharged into rain forest streams and rivers billions of gallons of tainted water generated by oil operations. Texaco considered but rejected spending modest sums to reduce ecological harm.

The human toll from Texaco's pollution was exacerbated by Ecuadorian government policies. While some of the rain forest residents affected by the contamination were members of tribes indigenous to the region, far more were farmers encouraged by the government to move to the oil region under an official policy known as "colonization."

Both Texaco and the country of Ecuador profited from oil production. In fact, the vast majority of the proceeds from Texaco's oil activities remained in Ecuador. Many people assume that multinational petroleum companies make off with the lion's share of revenue generated in places such as Ecuador. Whatever the pros and cons of hosting foreign oil companies, however, resource-rich countries typically retain most of the revenue. In Ecuador, some 90 percent of the roughly \$25 billion produced by oil activities in the 1970s and 1980s remained in Ecuador.

In the early 1990s, the Ecuadorian government nationalized its oil industry and sent Texaco packing. Back in the United States, Texaco faced an unfriendly "welcome home." A group of American plaintiffs' attorneys filed a class-action suit in federal court in New York in 1993, accusing the company of environmental negligence and seeking \$1 billion on behalf of Ecuadorian farmers and tribe members. The courtroom war had begun.

Texaco responded in two ways. In New York, it sought to get the class action dismissed by arguing that the only appropriate place for such a suit was Ecuador, the location of the alleged wrongful conduct. In Ecuador, the company negotiated a cleanup plan with the government in Quito under which Texaco assumed responsibility for "remediating" one-third of an agreed-upon list of contaminated sites; Ecuador took responsibility for the rest. In 1998, the Ecuadorian government certified Texaco's cleanup as adequate and gave the company a formal release from further liability. Three years later, right around the time Chevron was acquiring Texaco, the

federal courts in New York sided with the combining oil companies and told the plaintiffs, in essence: Take your complaints to Ecuador.

Chevron had based its winning argument for dismissal of the American class action on the contention that Ecuador's courts were strong, independent, and competent. The company would soon learn the wisdom of the old adage, "be careful what you wish for."

Chevron believed that the Ecuadorian judicial system wouldn't pose a threat because the Ecuadorian courts had no mechanism for hosting class action suits. In 1999, however, the same American plaintiffs' lawyers who were pressing the case in New York consulted with Ecuadorian legislators on the enactment of a statute that provided for the first time for mass lawsuits in Ecuador. This statute was applied retroactively to Chevron.

Sure enough, the lawsuit against Chevron restarted in the provincial courthouse in Lago Agrio in 2003. Both sides employed tactics that would not pass muster in the United States. Chevron, for example, allied itself with the still-influential Ecuadorian military, going so far as to house its legal team on a military base in a residence the company built and promised to bequeath to the military upon the conclusion of the litigation.

The plaintiffs' legal team, now headed by a brash New York-based attorney named Steven Donziger, thoroughly outflanked Chevron when it came to unconventional legal tactics. Donziger cajoled and bullied Ecuadorian judges in private meetings and communications. He manipulated a supposedly neutral court-appointed expert, going so far as to arrange for the secret ghostwriting of the expert's submissions to the court. And he choreographed the illicit payment of a former judge in Lago Agrio to write pro-plaintiff rulings issued under the name of the presiding judge.

Ultimately, according to the March 4, 2014 opinion of U.S. District Judge Lewis Kaplan in Chevron's successful racketeering suit against Donziger, "the plaintiffs' team wrote the Lago Agrio court's judgment themselves and promised \$500,000 to the Ecuadorian judge to rule in their favor and sign their judgment."

Donziger received ample cooperation from Ecuadorian judges eager to sell their influence to the highest bidder. Four out of the six judges who at one time or another presided over the Lago Agrio case were removed from office for misconduct. When questioned under oath in a U.S. courtroom, the judge who signed the 2011 opinion justifying the \$19 billion verdict against Chevron seemed entirely unfamiliar with his own purported work. This same judge, who speaks and reads only Spanish, peppered his ruling with references to American, English, and French law. Asked about this during sworn testimony, he explained implausibly that his only assistant, an 18-year-old high school-educated typist, found the citations on the Internet.

"This case," Judge Kaplan wrote. "include[s] things that normally come only out of Hollywood.... If ever there were a case warranting equitable relief with respect to a judgment procured by fraud, this is it." The equitable relief Judge Kaplan granted took the form of an injunction forbidding Donziger and his clients from profiting from the fraud perpetrated in the Ecuadorian courts.

Donziger has not surrendered. He has appealed Kaplan's ruling to the U.S. Court of Appeals for the Second Circuit, emphasizing that two levels of appellate courts in Ecuador reviewed the Lago Agrio verdict and waved off Chevron's allegations of fraud and extortion. In a saga whose actors seem immune from any sense of irony, Donziger now heralds the Ecuadorian courts as a bulwark of justice. These are the same Ecuadorian courts that years earlier he claimed could never give his clients a fair trial.

Donziger and his clients can't enforce the Ecuadorian verdict in that country because Chevron has no assets to speak of in Ecuador. So the plaintiffs have taken the Ecuadorian verdict to third countries where the company does have assets--Canada, Argentina, and Brazil--and are seeking enforcement there. Chevron, in response, will argue to judges in those third countries that the U.S. ruling that Donziger is a racketeer ought to preclude enforcement anywhere.

After more than two decades of legal wrangling, this litigation has not resulted in the elimination of any waste oil, the purification of a single Amazon stream, or the construction of a medical clinic for the poor. To the contrary, the endless *Bleak House*-style lawyering has provided the Ecuadorian government with an excuse not to take steps that could help its people. The Quito government hasn't fulfilled its long-standing contractual promise to clean up the two-thirds of the former Texaco contamination sites. Since assuming a lead role in the Amazon oil zone, the national oil company, Petroecuador, has proved itself to be, if anything, an even worse polluter than Texaco. More than two decades after Petroecuador took over, it's increasingly difficult to say which oil company contaminated which site. Campaigning against Chevron--and for enforcement of the dubious Lago Agrio verdict--has become a central theme of the administration of President Rafael Correa.

The story I tell in **LAW OF THE JUNGLE** has many victims but no heroes. It is a story in which legal procedures and judicial remedies have not dealt effectively with the harsh side effects of industrialization of an area such as the Oriente in Ecuador. Rather than serve as a means for holding corporate power accountable, the rule of law has been undermined.

I'd be pleased to answer your questions. Thank you.

STATEMENT OF THE HONORABLE JOSE W. FERNANDEZ, PARTNER, GIBSON, DUNN, & CRUTCHER LLP (FORMER ASSISTANT SECRETARY, BUREAU OF ECONOMIC, ENERGY AND BUSINESS AFFAIRS, U.S. DEPARTMENT OF STATE)

Mr. FERNANDEZ. Thank you, Mr. Chairman. Thank you for holding this hearing and this is an issue I commend this subcommittee for talking about.

I first came across the issue of rule of law in Latin America as a young lawyer in 1985. I had been named the head of the ABA's—American Bar Association—Latin American Law Committee and I decided to go down to Central America that was undergoing the civil wars of the 1980s. I remember going to the Supreme Court Library with the head of the Supreme Court of El Salvador and asking him where he had his law books. And he looked at me sort of funny and he showed me the library and it turned out the library had no new books since 1968. And yet, every day they were deciding cases.

I mentioned this incident not to illustrate the challenges of the rule of law, that the challenges of the rule of law are something that is odd. I mention it to illustrate that the challenges of the rule of law are not new. They are long standing and will take a long time to fix. And while we can help, these challenges will only be overcome with domestic support and local buy-in from local governments, lawyers, private enterprise and civil society. But until they are addressed, these challenges will continue to hinder all commercial activity in Latin America, be it from domestic investors or foreign investors.

To be sure, we have a number of bright spots in the Latin American rule of law firmament according to the World Justice's Project Rule of Law Index for 2014 which ranks 99 countries based on indicators such as constraints in governmental powers, absence of corruption, open government, regulatory enforcement and the like. You have got countries such as Uruguay, Chile, and sometimes Costa Rica that actually do quite well in these rankings and sometimes they even outrank the United States. But for the most part, overall, the region falls to the bottom third in most of the factors used by the WJP.

And why doesn't the U.S. investor decide to put his money in a country? And in 30 years of practice, I have come to the conclusion that in part, it is about the opportunity, but it is also based on that investor's perception of whether the legal system is transparent, stable, and free from bias and corruption, where the property rights are enforced and whether fundamental personal rights are also respected. And in all of these scores, Latin America certainly is doing better than it did 20, 25 years ago, but it still has a long way to go.

According to Transparency International, their corruption perception index which ranks the perceived levels of public sector corruption in the 177 countries around the world, over two thirds of the nations in the Americas scored less than 50 which indicates a serious corruption problem. Venezuela, which has been mentioned here several times, was 160th out of 177 countries in the Transparency International corruption index. And when Transparency asked people in Latin America whether they thought that high

ranking government official exposed for taking government money was likely to be prosecuted or punished, less than 30 percent of Latin Americans answered yes. That is the lowest percentage of any region in the world.

Another indicator is Latin America does not do much better. Central America, Venezuela, and several other countries rank among the most dangerous countries in the world and yet the conviction rates in Latin America are abysmal. In Panama, only 12 percent of burglars are captured, prosecuted, and punished. And that 12 percent is the highest percentage in all of Latin America. In Venezuela, that number is 1 percent.

For murder cases, for homicides, Honduras has seen a 250 percent increase in homicides in the last few years. But the impunity rate in Honduras is 90 percent. Even Mexico, a study last year showed that 80 percent of homicides go unpunished without conviction or even trial.

I experienced the consequences of a failing rule of law system when I led the team that negotiated the Partnership for Growth agreement between El Salvador and the U.S. last year. And one of the things that I learned there is that when you talk to businesses who were not investing in El Salvador and asked them why, they said it is crime and it is insecurity. You even had circumstances where employers agreed with employees that they would pay them on random weeks. They would pay them on one week and then they wouldn't pay them for another month. Then they would pay them the next day. And why was that? Because if they paid them on a regular schedule, those employees would be robbed and assaulted in their buses on the way home. Just imagine investing in that kind of a scenario.

But there are a number of ways that the U.S. can help here and I would like to be able to talk about that during the discussion. Obviously, the MCC is helping. Obviously, programs such as USAID's programs to support the administration of justice in Latin America. It seems to me that as we negotiate free trade agreements, bilateral investment treaties and the like, we ought to make sure that investor-state arbitration provisions are included and we ought to be negotiating even more free trade agreements with our partners in Latin America.

At the end of the day, the U.S. is blessed with a legal system that is admired throughout the world and we can help Latin America improve its rule of law system, not really by grafting our traditions on to these other countries, but by partnering with them as they seek our support to improve their judicial and enforcement institutions. Thank you.

[The prepared statement of Mr. Fernandez follows:]

Statement of Jose W. Fernandez
Partner, Gibson, Dunn & Crutcher LLP
Subcommittee on Western Hemisphere, House Committee on Foreign Affairs
“Building Prosperity in Latin America: Investor Confidence in the Rule of Law”
July 30, 2014

Chairman Salmon, Ranking Member Sires, and members of the Subcommittee on the Western Hemisphere, I am honored to have the opportunity to appear before you today to share my views about the rule of law in Latin America as it affects foreign investment. I commend the Committee for holding this important hearing.

I first traveled to Central America in 1985 as a young law firm associate. I had just been named Chair of the American Bar Association’s Latin American Law Committee largely, I am convinced, because Latin America was going through the “lost decade” and no one else wanted the job. I was then asked to spearhead the ABA’s efforts to improve the rule of law in Central America.

What I learned on that first trip has stayed with me forever. On the first day of my visit, my meeting with the US Ambassador to Guatemala was cut short when the Ambassador’s secretary slipped him a note. The top labor leader in the country had just been given two hours to leave the country -- or else -- by unidentified gunmen, had no place to hide, and needed American help to flee the country. Apparently that was not unusual during labor negotiations in those days. On the next leg of the trip, in Panama, the administration of General Noriega looked askance at an American organization’s efforts to improve the country’s judiciary.

But nothing prepared me for what I saw in El Salvador. Never mind that in the midst of a bloody civil war my meetings at the Salvadoran Supreme Court were constantly interrupted by the staccato of gunfire nearby. When the Chief Justice of the Supreme Court -- who would be assassinated by a car bomb two years later -- showed me the library, I noticed that there were no law books beyond 1968. “Where are the statutes and cases for the last 20 years?” I asked. “We have only a couple of books since 1968”, he shrugged. “We just don’t have the money.” That’s when I decided that, if we wanted to help Central America escape its cycle of violence and poverty by encouraging commercial development, one of our first projects would be drafting a commercial arbitration code. In this part of Latin America, no sane businessman would trust his investment to the local judiciary.

I mention this incident to illustrate that the challenges to the rule of law are not new. They are long-standing, will take a long time to fix, and -- while we can help -- will only be overcome with domestic support and buy-in from local governments, lawyers, private enterprise and civil society. And until addressed, these challenges will continue to hinder all commercial activity, be it foreign or domestic.

To be sure, there are some bright spots in the Latin America rule of law firmament. According to the *World Justice Project’s Rule of Law Index* (WJP) for 2014, which ranks 99 countries

based on indicators such as constraints on governmental powers, absence of corruption, open government, regulatory enforcement, and civil and criminal justice, countries such as Uruguay and Chile place high, sometimes higher than the United States in several criteria. But overall the region falls to the bottom third in most of the factors used by the WJP. So today the vast majority of foreign investors going into Latin America still prefer arbitration, as opposed to the local courts, as a means to resolve their disputes.

But as I learned in thirty years of representing investors in Latin America, arbitration is not a panacea. The problem is broader. Not everyone can arbitrate, and even when you can at some point in the arbitration you may need to resort to the local courts. Plus local investors, especially small businesses, are not always familiar with arbitration. More importantly, a decision to invest is not merely based on the availability of arbitration. It is based on an investor's perception of whether the legal system is transparent, stable and free from bias and corruption, whether property rights are enforced, and whether fundamental personal rights are respected. As the WJP points out:

Imagine an investor seeking to commit resources abroad. She would probably think twice before investing in a country where corruption is rampant, property rights are ill-defined, and ineffective means to settle disputes undermine legitimate business and drive away both domestic and foreign investment.

On all of these scores, Latin America certainly fares better than it did three decades ago, but it still has a way to go.

According to *Transparency International's Corruption Perception Index*, which ranks the perceived levels of public sector corruption in 177 countries and territories around the world, over two-thirds of the nations in the Americas scored less than 50, indicating a serious corruption problem even after including Canada which scored 81 and the U.S. with a score of 73. Venezuela was 160th out of 177. When asked by respondents whether a high ranking government official exposed for taking government money was likely to be prosecuted or punished, less than 30% of Latin Americans answer yes, dead last among all regions of the world.

In other indicators Latin America does not fare much better. Central America and Venezuela rank among the most dangerous countries in the world, and the population's perception of safety -- when asked if they feel safe or very safe when walking around their neighborhood at night -- is less than 40%, again the lowest of any region. No wonder: the conviction rates in Latin America are abysmal. In Panama, only 12% of burglars are captured prosecuted and punished. And 12% is the highest in Latin America: in Venezuela the number is 1%. As for murder cases, Honduras has seen a 250% increase in homicides in the last few years, but the impunity rate is over 90%. Even in Mexico, according to one study from last year 80% of homicides go unpunished without conviction or even trial.

I could go on, but you get the picture. In other traditional indicators of the rule of law, such as ensuring compliance with regulations, and the effectiveness of judicial oversight, there is still

much room for improvement in Latin America, despite the undeniable advances we have seen in places such as Brazil, Mexico and Colombia.

Both in private practice and in government, I have witnessed how weaknesses in the rule of law can impact investment, in addition to wreaking unspeakable human tragedy. El Salvador has had the lowest rate of foreign investment in Central America for several years, and when we asked business -- both local and foreign -- why, the reason given almost always was insecurity. Crime affected all levels of Salvadoran commercial life, to the point that paydays were random because if the gangs knew when employees received their salaries they could plan when to assault the buses taking the workers home. As a result, in El Salvador some workers actually do not know if they will be paid today, this week, or next. Imagine trying to motivate your workforce under those conditions. That's why when we looked for ways to stimulate the Salvadoran economy as part of the Partnership for Growth (PFG) -- our cooperation agreement with the Government of El Salvador that I was fortunate to help negotiate -- the first item we looked to improve was the rule of law. Today much of the emphasis of the PFG in El Salvador is on strengthening justice sector institutions, improving criminal procedures and strengthening the civil service, including the courts.

The PFG was just one of the ways that the Obama Administration tried to help willing Latin American governments improve the rule of law during my time in Washington. Other parts of the U.S. government also worked to do the same. One of the principal requirements for Millennium Challenge Corporation grants, for example, is that countries commit to minimum rule of law standards. USAID has also supported legal reforms programs throughout the hemisphere for many years, including most recently in Mexico, Colombia and Central America.

At the end of the 1980's, as the Central American conflicts subsided, our funding at the ABA was cut just as we finished putting together draft labor and commercial arbitration laws for the region. But our efforts were not for naught. Recently, my old colleagues at the ABA, now called the Rule of Law Initiative ("ROLI"), have held several workshops in Mexico in the new "accusatorial" style justice system, modeled in part after the American system, which will be implemented throughout Mexico by 2016. They have also hosted workshops on criminal investigation and crime scene processing in Central America. I am proud of the work of the ABA for the last three decades, and hope that this time the funding will continue. It may not be flashy, headline-grabbing work, but it remains essential if we are to support our Latin American partners as they seek to improve the rule of law.

But the U.S.'s efforts to help Latin American countries improve the rule of law should not be confined to technical assistance workshops. The new Model BIT that was finalized in 2011 imposes high level environmental and labor standards on all parties, and requires that the host country generally accord foreign investors the same treatment received by locals. It also includes procedures for investor-State arbitration, a key request from our business community. Washington should continue to press our Latin American neighbors that today are not party to a regional or bilateral trade agreement with the United States -- such as NAFTA, CAFTA-DR and various FTAs and BITs -- to negotiate and sign on to a BIT with the U.S. We should not be deterred in these efforts by Ecuador's and Bolivia's disappointing decisions to terminate our

bilateral investment treaties. And when the Trans Pacific Partnership Agreement is finalized, the U.S. should move quickly to bring other like-minded Latin American nations into this trade pact.

At the end of the day, however, the rule of law in Latin America can only be advanced by the Latin Americans themselves. To do so, in addition to dealing with the deficiencies already mentioned, they will have to devote more resources to their judiciary, to their law enforcement capabilities and to providing more economic opportunities for their youth. This will require funding, but -- as I recently argued in the Council of the Americas' *Americas Quarterly* -- today many Latin American nations, especially in the Caribbean and Central America, face unsustainable debt levels and cannot devote more to improving the rule of law. Poor tax administration hampers efforts to finance public investment. While at the State Department, we began a pilot project called "Domestic Finance for Development", or "DF4D", to improve public revenue administration in three Latin American countries. The premise of the project was that the elites and the new middle classes will not pay taxes, and informality will persist, unless taxpayers are convinced that their funds will not be siphoned off to offshore bank accounts and will instead be used, transparently, for agreed public purposes such as improving the rule of law. Whether through DF4D or another mechanism, many Latin American governments will need to allocate more resources to their judicial and law enforcement agencies.

Blessed with a legal system that is admired throughout the hemisphere, the United States can help Latin America improve its rule of law system, not by grafting our legal traditions on to other countries, but by partnering with nations that seek our support to improve their judicial and law enforcement institutions. Doing so will mean not only fairer, more open and more stable neighbors, but also countries that are more attractive to both domestic and foreign investment.

I welcome this Committee's attention to these issues and look forward to your comments and questions.

Thank you.

Mr. SALMON. Thank you, Mr. Fernandez. That concludes the opening statements and I would like to yield myself 5 minutes to ask questions and then I will yield to the ranking member.

Ambassador Glassman, to what extent does the diminished U.S. diplomatic presences in Bolivia and Ecuador hinder the U.S.'s ability to support U.S. companies and investors in those countries? And what resources or recourse does U.S. investors have if they encounter difficulties with governments such as Bolivia that have revoked bilateral investment treaties and eschewed participation in international dispute resolution mechanisms?

Ambassador GLASSMAN. Well, the quick answer to that is very little. It is a major problem, not just for American investors, but I would say for those countries themselves because they are the ones who are being denied the kind of prosperity that they should have through a sound rule of law. But I do think that in many ways, the U.S. should become much more concerned and engaged in Latin America countries, both those that are not abiding by the rule of law and those that are who really need encouragement. I am sad to say that I don't think we have been doing that.

Mr. SALMON. I would agree with you. I guess on another front Ecuador has shown little regard for property rights, particularly intellectual property rights. In fact, this year, USTR again placed Ecuador on the specialty 301 Watch List due to failure to adequately protect U.S. intellectual property. And these anti-innovation policies, they do harm the U.S., but they also harm Ecuador which is locking her people out of today's knowledge-intensive economy.

What tools do we have in our arsenal to encourage Ecuador to adequately respect property rights, both tangible and intangible?

Ambassador GLASSMAN. I really think that one of the major tools that we have is the bully pulpit. The State Department does issue a report every year that covers the economic climate in countries like Ecuador. My written statement does refer to that. I just want to quote one sentence from it. This is about Ecuador:

"Frequent changes in Ecuador's tax code make business planning difficult, in general, the legal complexity resulting from the inconsistent application and interpretation of existing laws complicates enforcement of contracts and increases the risks and cost of doing business in Ecuador."

We have the means through what the Secretary of State says, what the President might say to affect the policies of Ecuador. And I think that we should be talking about it.

Mr. SALMON. Mr. Fernandez, to what extent is corruption an impediment to a healthy investment climate? And do you know to what extent does the United States support anti-corruption initiatives in Latin America? Which countries have improved their anti-corruption capabilities as a result of such assistance?

Mr. FERNANDEZ. Corruption is an issue in Latin America in a number of countries and it is an issue for U.S. investors in large part because we are constrained, they are constrained by the Foreign Corrupt Practices Act. And that is something that will have repercussions back at home.

I have found that it differs depending on the country. You look at countries such as Chile, as Uruguay, or you and I would go into

court there and feel that we can get a good hearing. In other countries, it is a problem and it is many, many countries where what we have tried to do in government was to support transparency efforts, to work with the American Bar Association, to work with others to support anti-corruption measures.

Ultimately though, we have got to be able to get the support of the local population because they are the ones that ultimately are hurt by corruption. Corruption hurts for the most part poor people, people who can't pay. And I think that is part of what we need to do more of over the years.

Mr. SALMON. Well, Peru is maybe a more positive example, they are experiencing growth somewhere between 4 and 5 percent and they will be probably for the next 4 or 5 years. What are they doing different compared to its counterparts such as Venezuela and other countries to create jobs and effect domestic investment?

Mr. FERNANDEZ. Mr. Chairman, I actually represented Peru when they privatized their phone company 20 years ago and I would like to take credit for a little bit of their growth. One of the things that they did is they did away with a lot of the government bureaucracy. It became a lot easier to get permits in Peru in order to do business. The more red tape that you have in these countries, the easier it is for somebody to get paid. So that is something that they did. They also provided a number of guarantees for investors and they also made very specific statements that they were going to welcome foreign investment. That, I should say, in many cases has not made the ruling Presidents quite popular. They have had to buck a lot of political pressure. But overall, if you look at the macro growth in Peru, a lot of it is due to the fact that they made it very clear for the last couple of decades since they did away with the shining path, that they are going to support foreign investments and that they are going to do anything that they can in order to attract and keep the foreign investor.

Mr. SALMON. Thank you. My time has expired. Mr. Meeks?

Mr. MEEKS. Thank you, Mr. Chairman. And I have to first want to associate myself with Mr. Connolly in regards to the opening remarks. I couldn't disagree with you more in reference to your opening statement. I just wanted that to be clear for the record because I think it is important as we discuss the prosperity, building prosperity in Latin America that oftentimes I don't like to get into even if some sides do it, they say two wrongs don't make a right, etcetera. I get upset if somebody is name calling the United States. I don't think we should go back and name calling them and back and forth with Presidents, particularly when I have had the opportunity to travel to certain places.

And when I look at say the President of Bolivia, for example, who is the first indigenous President in the country's history and how proud those individuals are of their President, I don't think that—I know even when we don't like our President, whoever that President is, to be name called by anyone else and I don't think that we should do it with them.

When I think about some of the countries that we are talking about and I really appreciate the testimony of all of the witnesses here, I think they were extremely important, but when I think about governance and access to government to a large part until

recently many of the people that were impoverished and indigenous and others had no access to government at all. I mean that's why some people who are elected is because of the fact that poorest of the poor in these communities didn't, couldn't access government and didn't vote in elections.

It reminded me as we celebrate the 50th anniversary of the Voting Rights bill here in the United States of America. Just 50 years ago, a lot of folks could not vote in the United States of America. We have come a long way and sometimes it is difficult to expect somebody else to make the same kind of progress that we made in almost 240 years, we are asking them to make in a smaller period of time. But when I look at it, the American economic ties to Latin America continues to deepen in many places like Chile, Peru, and Mexico's participation in TPP negotiations represents a great step forward in multi-lateral collaboration on trade and despite actually sometimes what we hear, Bolivia, believe it or not for some has nearly tripled its per capita income since the early 2000s and attracted a record \$2 billion in foreign direct investment last year. So clearly Bolivia is open for business. Ecuador has taken steps to foster small business development and to improve market access. And its economy has averaged more than 5 percent growth annually since 2010. It is obvious that Americans are doing business there and still investing in Latin America even where there are challenges because I am not saying that there are not challenges. There are very big challenges that we still have got to confront. And I think that you have indicated what some of those challenges are in your testimony.

But my thing is just imagine how many more opportunities there would be if we could tackle some of the toughest challenges facing American businessmen and women. I believe as you have indicated, we have to have strong rule of law, respect for intellectual property rights, and a fair and independent judiciary are absolutely essential for fostering an environment conducive to doing business. In fact, it is one of the main reasons why I support free trade agreements because I believe that we can lift up the standards, but not bring down the standards as some say. So we need to lift up the standards. That is why I also support trade capacity building. When I voted for CAFTA, one of the few Democrats that did so. I thought trade capacity building was absolutely essential if we were going to pass that bill so that they would have the capacity to grow and trade and improve their institutions. That is tremendous. So I believe the free movement of goods and services is at the heart of all stable democracies, as long as everybody has the chance to participate.

I am a strong supporter of Colombia. Yet, I had some Colombians that came in that were from the Pacific Coast who wanted to make sure that they were included in the trade agreement because we could have disparity if they are not and if they don't develop that capacity.

So my question after going through my little statements there is this. I will ask Mr. Fernandez because the other thing is I do believe in doing things multilaterally and I want to talk about how we can help. Does the Inter-American Development Bank or any other regional multilateral institutions have any programs in place

to improve the climate for investment in Latin America and Caribbean countries which we see that there is some problems? Is there anything that you know of that nature?

Mr. FERNANDEZ. Well, my information is a little bit dated now, I have been out of government for a few months, but USAID has very strong programs in Latin America to improve the rule of law. They fund organizations such as the American Bar Association, MCC, the IDB as well. I think you have a number of programs and you have a number of organizations in the U.S. that help. I think we need to support them. One of the problems that we found when I ran the ABA's rule of law initiative for Latin America is that sometimes the programs were cut. And I remember writing and drafting an arbitration, commercial arbitration law for Central America in order to make sure that U.S. investors didn't have to go to the Salvadoran Supreme Court in order to get their disputes heard. And just as we were done our funding was cut simply because of the civil strike in Central America stopped and therefore the interest stopped.

I think we need to realize that in places like Venezuela corruption was there before the current administration. These things have been going on for a long, long time. And I think, not to by the way in any case minimize what is going on there, which is a tragedy both human and otherwise, but I think it is going to take us a while. I think we have to make sure that we support them and that we are steadfast be it a Republican administration or a Democratic administration. Thank you.

Mr. MEEKS. Thank you. Mr. Glassman, do you want to add anything?

Ambassador GLASSMAN. First of all, I would just like to say that I have been an admirer of your support for free trade for a long time. And I think that ultimately is one of the most important ways that we can help in the United States. So I certainly hope that TPP does go through.

I would just say that as far as Bolivia and Ecuador are concerned, Bolivia ranks 158th on the Economic Freedom Index and Ecuador is 159th. They have a long way to go. In general though, I would associate myself with your comments about the progress that Latin America has made and from a very, very difficult past. But there is, I think, wide disparities as I said in my testimony between some countries and other countries and it is not ideological.

I mean Peru is actually a good example of a country which you might say has a kind of a left of center government where it is very clear that the administration understands that in order to attract the kind of business that will lift everybody up, it needs to be much more friendly to business and abide much more by the rule of law.

Mr. MEEKS. Thank you.

Mr. SALMON. Thank you. The Chair recognizes Mr. Duncan.

Mr. DUNCAN. Thank you, Mr. Chairman. It is difficult for a nation which is in debt to the tune of almost \$18 trillion to discuss or preach to other nations about their looming debt crises, but having said that let me just say that I am deeply concerned about the direction of Argentina and its ability to influence other Latin American countries in following its poor example.

I agree with you, Mr. Chairman, that we should be doing all that we can to laud the positive examples of countries such as Mexico, Chile, Colombia, Uruguay, Peru, Barbados, St. Lucia, Costa Rica, because they have all shown great promise in taking actions that value economic freedom and growth.

I think we do, however, have a responsibility to discuss the rule of law. In fact, the U.S. bond holders who might face significant risk and U.S. taxpayers who in the case of Puerto Rico might be on the hook should there be some sort bail out there. I am concerned when government tears up an agreement as we saw with Doral and thus weakens the rule of law.

So I would like to address a few questions to Ambassador Glassman first. Do you believe Puerto Rico is at risk of defaulting on its debt?

Ambassador GLASSMAN. I do. And probably more important so do very, very close observers of Puerto Rico at places like Nuveen and other bond houses that really watch these things. Barclays. Thomas Weyl at Barclays is probably the most closest observer of what is going on in Puerto Rico among finance people, says that Puerto Rico is very close certainly.

Mr. DUNCAN. Just as a side note, Morningstar reported that 67 percent of all United States municipal bond funds have exposure to Puerto Rico, general obligation to that agency debt. Because Puerto Rico is a U.S. territory rather than an independent nation, would you say, Ambassador, that U.S. taxpayers are responsible for bailing out Puerto Rico if it defaults on its debts?

Ambassador GLASSMAN. I don't know the answer to that question, but my guess is that if worse comes to worse that we will be on the hook. And I think that the U.S. Congress should be extremely vigilant about what is happening in Puerto Rico right now. So it may turn out that we have no legal obligation, but I kind of doubt that. And we need to watch it.

Just your reference to bond mutual funds, in my written testimony I talk about the fact that many state bond municipal funds, mutual funds have very heavy reliance on Puerto Rican bonds and that will come as a shock I think to many small investors. For example, I point out that in its most recent report, Oppenheimer Rochester Maryland Municipal Bond Fund owns about 25 percent—has about 25 percent of its assets in Puerto Rican bonds because they are triple tax free.

One of the problems that has developed in Puerto Rico is that borrowing has been quite easy because its bonds are so attractive. They are triple tax free. It doesn't matter what state you live in, the interest is exempt from federal, state, and local tax.

Mr. DUNCAN. And I would say that there is probably a lot of pension funds which are struggling financially anyway that are heavily invested. Let me shift gears because I read an article in the Washington Post by Mike Debonis back in January 2011 he was talking about the Financial Control Board here in DC. So in your testimony, you mention the U.S. could consider a federally appointed Financial Control Board to help manage Puerto Rico's financial situation. What would that look like and what would be the impact of such an entity? And do you think that is the right idea?

Ambassador GLASSMAN. I think it is a good idea. I don't know whether we are there yet, but I think it is time to start looking at it and the Financial Control Boards both in New York and Washington, DC, were very effective. So the Washington Control Board went into effect in 1995 and was disbanded in 2001. It had very broad powers, including the powers to approve any bond issues, hiring, firing. It had a distinguished board that included Alice Rivlin, the former Vice Chair of the Fed. And it worked very effectively, so I think that U.S. Congress should take a look at the possibility right now of a Financial Control Board.

I am not saying it should be instituted now, but I think preparations ought to be made. We are talking about \$73 billion in debt. That is a lot of debt for a U.S. territory with a population of 3.7 million. And with some very poor institutions like the Puerto Rican Electric Power Authority. A majority of its generating capacity comes from oil which is very expensive and needs much more capital investment to get to natural gas and some of the other better fuels. So I do think now is the time to start looking at it, that is for sure.

Mr. DUNCAN. My time is about up, but with no more participation, let me just ask you does Puerto Rico have a balanced budget amendment?

Ambassador GLASSMAN. I don't know the answer to that. The last time I looked there was——

Mr. DUNCAN. Is there a requirement in their constitution?

Ambassador GLASSMAN. I don't know the answer to that.

Mr. DUNCAN. They should and we should, Ambassador. And that is the point I wanted to make.

Ambassador GLASSMAN. Right. Thank you.

Mr. DUNCAN. They should and we should. Thank you. I yield back.

Mr. SALMON. Thank you, Mr. Duffy. Oh, he is gone. Mr. DeSantis.

Mr. DESANTIS. Thank you, Mr. Chairman. Thanks to the witnesses.

Mr. Glassman, I just wanted to touch on a couple of things domestically because I have really respected your writing and I think you have always been a supporter of pro-growth policies here. And specifically with the rule of law, I know that you had written about the problems with the Chrysler and GM bankruptcies at the onset of this administration. I look back at that from the beginning to even use TARP funds which was first done by Bush, then by Obama. The law did not provide for that. And then, of course, the problems with the actual bankruptcy where the creditors were basically pushed out in favor of the unions. So I guess my question is, is that whole enterprise, do you think that that has left some lasting damage?

Ambassador GLASSMAN. I do. I think that the treatment of the bond holders of GM and Chrysler who were, as you say, shunted aside for what I would say were political reasons or certainly were not treated the way they should have been treated, has left some lasting damage.

This is a hearing about rule of law and the United States, as several members have already said, it has not been perfect. One of the

things that disregard for the rule of law does is it raises the cost of capital for corporations, for governments and I think that the behavior of the government during that period I think was damaging going forward, yes.

Mr. DESANTIS. And I am concerned, too, if you look at how the healthcare has worked. There was a problem when the law kicked in last year. People started getting their plans canceled. We did some in the House. They didn't want it reopened in the Senate, so the administration said okay well, just keep your plan. So now I have constituents who will call me and say look, my plan was canceled. They said I could keep it, can I keep it next year? I am like well, the law of the books says it is illegal, but they say they are not going to enforce it and so you end up in the situation, I have businesses saying okay, is this employer mandate going to apply? Now they say if I have 87 employees I am in a different zone even though the statute doesn't say anything. And of course, our Oversight Committee just put out a report where the administration and the insurance companies are going back and forth and they are trying to kind of figure out ooh, maybe we can take this money for the reinsurance and risk corridors and all that.

So I guess what I am seeing is kind of the administration arm of government working with really big institutions in the private sector devising rules as they go along. I don't think that is conducive to a really solid pro-growth future here. What are your thoughts on that? Am I right to be concerned?

Ambassador GLASSMAN. I do think you are right to be concerned. I just read that quote from the State Department about Ecuador which talked about how they keep changing their tax laws, keep changing all sorts of laws. And that has discouraged investment. There is no doubt what investors want is stability, confidence in the rule of law and the United States stands pretty high up on the charts, but we are far from being perfect. And when we neglect the rule of law, when we neglect consistency, it hurts prosperity ultimately.

Mr. DESANTIS. Without question. I think Lincoln's first big speech was 1838 and he said, "Founding Fathers have passed and the memory of the Revolution is gone." The rule of law, we all have to rally around that and really respect our institutions and respect what that does for our freedoms. I think what he said then is true today.

Let me ask you about, now getting back to the rule of law in Latin America. The courts, how would you rate the courts in places like Bolivia, Ecuador, and Argentina? It seems like what I read is they are generally very negative, particularly with corruption, so if the witnesses would like to express their views, I would appreciate that.

Mr. FERNANDEZ. They vary. I have been involved in a number of countries where it has been fine for my clients to go to the courts in those jurisdictions, as I mentioned, Chile, Uruguay. For the most part though I think you have a much more slower court system in Latin America, much more paper intensive. The quality of the judges differs. For the most part, I think foreign investors in these countries would prefer to go into international arbitration. And that is why if you look at the trade agreements that are out there,

the Trans-Pacific Partnership, Bilateral Investment Treaty models, in all of them we have put in international arbitration investor state arbitration. Those are the kinds of cases that will give our investors the assurances that their rights will be enforced. And it seems to me we ought to make sure that those are included in the final version of anything that we sign.

Ambassador GLASSMAN. Can I just add to that? You know, we were talking earlier about the Argentina case which may be resolved one way or another today and in order to sell those bonds that it later defaulted on, in the 1990s, Argentina had to agree that any case involving the bonds would be adjudicated in New York Courts. That is the only way that American investors could rely on Argentina. And I think that says a lot, as does the fact that international arbitration is a part of these treaties.

Mr. BARRETT. The Ecuadorian court system did not cover itself in glory during the long pendency of the Chevron case. The record shows clearly without any ambiguity that the judges involved in that case basically made themselves available to sell their influence to the highest bidder. This was explicit. They were going from one party to the other party saying how much would you pay me, how much would you pay me?

The judge who ultimately signed his name to the \$19 billion verdict against Chevron, when called to testify under oath in Federal Court in New York, and I was in the courtroom for his entire testimony, seemed entirely unfamiliar with his own work. He said that he spoke and read only Spanish and when asked how then was the case that he had made rather erudite references to American law, French law, UK law, Australian law, he explained those were the product of the research of one person, his 18-year-old typist who had found these references in internet research.

Now having listened to all of this and being in a position of authority, Judge Kaplan concluded that this judge really had almost nothing to do with this 188-page ruling that has had so much impact and then, in fact, other people wrote it and he was interested in being paid a bribe for it. So sadly, in one of the biggest commercial cases ever in the country, the situation was just shot through with fraud in Ecuador.

Mr. DESANTIS. Great. I really appreciate the testimony. I yield back.

Mr. SALMON. I think we are going to have another round of questions. We have got some more time. Can you stay just for a few other questions?

Mr. Barrett, your experience with Ecuador was pretty extensive, given the Chevron case and your reference to the lack of real integrity for the judicial system there in Ecuador is frightening. If you were general counsel for any large company in the United States, and they were considering opening up shop in Ecuador, what advice would you give them right now?

Mr. BARRETT. You are asking me to practice law without a license?

Mr. SALMON. Okay, let us say you weren't general counsel. Let us say you are CFO. Now I am asking you to practice——

Mr. BARRETT. It is getting worse and worse and more dangerous.

Mr. SALMON. Either way. I mean given your experience don't you think it is going to have a chilling effect on future investment?

Mr. BARRETT. Rather than putting myself in that position, let us just make the observation that the oil industry remains the backbone of the Ecuadorian economy. At one time, the U.S. oil industry was core to operating that. The U.S. oil industry saved the oil services companies which are still there is now completely gone and in fact, the Chinese dominate the oil fields in Ecuador which I think is troubling from the point of view of political influence in Ecuador. Ecuador is very much in hock to China. And if one is concerned primarily about environmental issues, I think you would be concerned about the Chinese operating the oil fields as opposed to American companies today.

So I think in that industry in any event, the petroleum industry, U.S. companies have voted with their feet and have left the country. So that would be one precedent I would look at.

Mr. SALMON. Absolutely. Ambassador Glassman, you mentioned, I can't remember whether it was in the body of your initial testimony or in response to a question, but that the United States can and should exert the bully pulpit to try to lead some of these other countries. Do you think that currently our Government is doing everything that it can to try to lead these countries in the right direction? And if not, what more should be done?

Ambassador GLASSMAN. No, I don't think it is. And I think that in my testimony I talk about, my written testimony, I talk about the Argentina case which has now gone on for 13 years. And the United States did some things that were good, absolutely, where for example, it refused to vote yes on credits to Argentina from the Inter-American Development Bank. But there was a lot more it could have done. And one example of that is the G20. So Argentina is a member of the Group of 20 which in itself is fantastic. Well, it was very surprising, let us put it that way.

So about 2 years ago, I did a study with Alex Brill of the American Enterprise Institute and looked at the question who should be a member of the G20? If you had objective criteria, what would they be? And who would qualify and who would not? And without going into all the details, Argentina ranked last among the current members of the G20 and there were about 20 countries that should have been on the list instead.

Well, the United States could easily have put pressure on Argentina through the G20 and told Argentina shape up or we will take some action to expel you. It is almost a mockery of the whole financial system that it is still a member. So that is an example. I would also say that there are things that the United States can do to encourage countries that are trying to do the right thing and one example in my testimony is Mexico which has taken great strides, its energy reform will be very important to the United States, and NAFTA has been very important to Mexico and the United States. And yet, we see the steel industry and the sugar industry in the United States filing anti-dumping cases against Mexico, which I think very much violate the spirit of NAFTA. And we have seen very little in the way of government support for the kinds of things, for encouragement of free trade from Mexico.

So I think there are lots of things that can be done and we are not seeing enough of those things.

Mr. SALMON. Well, I don't want to limit you just to the testimony today. If you have other thoughts that our Government can and should be doing, and you wanted to draft a memo for members of this committee, I promise you we will put it to good use. And I would really appreciate it.

Ambassador GLASSMAN. Thank you, Mr. Chairman.

Mr. SALMON. Thank you. Mr. Duncan.

Mr. DUNCAN. I just want to return real quickly to the rule of law and what has gone on with Doral down in Puerto Rico and in the Ambassador's written testimony in repudiating any of this debt to Doral, Puerto Rico is sending the worst possible message to other businesses, I agree. Who would want to continue to invest down there with this sort of environment and then it goes on to say that what company would want to overpay the government in light of Doral? Better to under pay and have the government fight for the money than to over pay and sitting there waiting on the government to repay you. The fact that they tore up an agreement for Doral to basically withhold or underpay its tax liability going forward until it reclaimed or recouped all of its money was, I think, a workable solution.

Ambassador, what possibility is there that Argentina will default on its debt? What is the real possibility? They have got the money, wouldn't you agree? From what I understand, they have got the money. It is just a matter of principle now.

Ambassador GLASSMAN. Yes. They do have the money. I think that there are elements of the government that are simply ideologically opposed to a settlement. But I also think that it is becoming clear to Argentina that it can't join the international financial community unless it gets this done. Now over the last 13 years, partly because of high commodity prices, it has been possible for Argentina to continue to have a half decent economy. But that has really changed quite a bit in recent years.

So I mean I don't know the answer to that question. It is going to happen probably in the next few hours.

Mr. DUNCAN. That is the G20. How can you allow a country to remain in an organization that is supposed to work on economic stability around the globe and they are defaulting on their debt?

Ambassador GLASSMAN. Right. It baffles me. I don't know the answer to that question. It really does not deserve, in my opinion, to be in the G20, Argentina.

Could I just make one comment?

Mr. DUNCAN. Yes, sir.

Ambassador GLASSMAN. About what you said about Doral. I say in my written testimony that the Doral case may also be a factor in a distressing report by Reuters that Puerto Rico's tax collections are running 27 percent behind budget. And nearly all that shortfall comes from corporate income taxes. So we don't know for sure if that is because corporations are saying oh, I don't want to overpay because I will get in the same kind of fix that Doral—and by the way, other companies have gotten into. But at any rate, there is this vast shortfall in corporate income taxes. And when people

don't pay their taxes, and businesses don't pay their taxes, that is one of the best signs that a government does not have confidence.

Mr. DUNCAN. I think that is a great statement. Mr. Barrett, I just ask you to chime in. It is a jungle out there. And you have written about the jungle. If Argentina defaults on its debt and you have got actions like Puerto Rico with Doral, what is the fix? From your standpoint as an author looking in, if you are going to write about this, what would you say the answer would be to the financial stability of these Latin American countries?

Mr. BARRETT. I am just going to have to be modest and not only not practice law or be a CFO, but I think that is a little bit beyond my level of credentials. I would want to inject just one thought here from the investor's point of view which is I think part of what you are driving at, I think all of these events are going to cause and ought to cause investors to be more cautious. And I think the marketplace is going to respond to these events. And it will be much more difficult to get large economic projects done in places like Puerto Rico and Argentina as a result and the people who will suffer will be the residents of those countries.

Mr. DUNCAN. Mr. Chairman, in their sense of time, I hope they don't follow the U.S.'s example of printing money in QE1, QE2, QE3, QE4, wherever we are at in the QE ratios because I don't think that is the answer. And I think having a balanced budget, I think doing things responsibly, paying your creditors back, and living within your means is a great start. That is an example that we can—that is a message we can send to them, but that is a message we should follow as a nation as well.

Mr. SALMON. So we just can't fall back on our old parental statement of just do it because I said so?

Mr. DUNCAN. No, I don't think that is fair and I yield back.

Mr. SALMON. Mr. DeSantis.

Mr. DESANTIS. Thank you, Mr. Chairman. Mr. Glassman, just turning to trade and particularly the issue that has come up where corporations—our tax system is so bad here that they actually can go incorporate overseas, acquiring an overseas company, move the headquarters, and then they are paying much less in terms of a corporate tax rate. I think the President is basically saying he wants to just chain companies here. I don't see how—that may even make it worse. So what would you recommend we do in order to attract capital here so that people are going to want to have businesses here, expand them, and not be driven away by our own policies?

Ambassador GLASSMAN. Well, I think there is little doubt what we need to do and I think there is something close to a consensus, but there are differences on some points. And that is lower our corporate tax, marginal corporate tax rate so that it is more in line with the rest of the world. So right now, it is 35 percent, 40 percent including state taxes, versus 24 percent for the average OECD developed country, so we are way, way out of line. Everybody has been cutting them for the obvious reason of attracting business. We have not.

Second, go to a territorial system which is almost what the rest of the world has, so you pay taxes where you do business. And third, close loopholes. I think the closing of the loopholes and the

increased business would mean you would get at least as much revenue as you are getting right now for the corporate tax which is very low. So what a normal corporation does or many corporations do is they pay the tax abroad. Let us say it is 20 percent. And then rather than bringing the money back to the United States and paying an additional 15 percent, they leave it abroad. So they have got \$2 trillion abroad.

In 2004, Congress closed what I think was a major loophole which was businesses were just opening a PO Box in the Cayman Islands and shifting all their assets there. And instead, defined very closely what an inversion is. And frankly, I think that law is perfectly fine. But no company would want to invert if we had a corporate—the kind of corporate tax reform that I just outlined and I think most Members of Congress want. So that is the imperative. That is the thing that is necessary. And in a way, maybe it is ironic but this inversion controversy which by the way only really involves a handful of companies, I think may finally drive corporate tax reform which I would love to see happen before the end of this year.

Mr. DESANTIS. One of the things that frustrates me just as a first termers is the way kind of Washington will score proposals. So for example, we were talking about you have all this money parked overseas as you said. Let us let people bring it back on a holiday very reduced rate, maybe like 5 percent. It could help for the Highway Fund or do other things if people want to do that. That would actually be scored as the government is “losing money.” Even though they wouldn’t bring it back under current rates, if you are lowering the rates, the way they will analyze it is saying oh, well, the government is going to lose all this money. So do you think there is a problem with the scoring conventions here? Because it seems to me that they don’t account for behavioral changes when policy makers are changing incentives.

Ambassador GLASSMAN. Absolutely. There is just no doubt about that. We need some kind of dynamic scoring. There is a problem though, of course, because there may be a lack of objectivity involved in dynamic scoring, but I think we all know that if tax rates dropped to zero or very low or their tax changes, that it does change people’s behavior. There is just no doubt about that.

Let me just also say that a company that does one of these inversions, so called, I prefer to call them foreign tax relocations because I think inversions have kind of a negative quality. A company, first of all, has to buy a very large company abroad. It has to be the main reason that they are doing the merger. It can’t be just for tax reasons. And after that is done, you have the very strong possibility and likelihood of money that is earned abroad coming back to the United States because it doesn’t have that extra layer of taxation. But ultimately, we don’t want to rely on these inversions of a few companies.

What we really need, what would really liberate the U.S. economy is to have the same kind of corporate tax system the rest of the world has and then the imagination and ingenuity, energetic nature of the American people will show that we can compete and beat anybody. But right now, we are just hobbling ourselves with

this corporate tax system. And by the way, not raking in very much in the way of tax revenue.

Mr. DESANTIS. I appreciate that. And part of the frustration we have is that we seem to shoot ourselves in the foot with some of these things with the economy. If our tax policies were competitive, people would flock here. This is a good place to be in spite of some of the problems that we discussed, we are still better off, but man, when you are creating these huge disincentives, capital is mobile and in this world-wide economy, it is going to move or it is going to stay offshore.

Mr. DESANTIS. Thanks, Mr. Chairman. I yield back.

Mr. SALMON. Ambassador Glassman, I would submit that if we put this proposal right now for a vote with this panel, that it would be unanimous. We would all vote to lower the corporate taxes down to a rate that is reasonable with the rest of the Western world and bring our companies back to the United States and let them repatriate without the penalties. And common sense tells you that the revenues would skyrocket if that happens, besides the fact that something is better than nothing which to me even an idiot can understand that. The other piece of it is that it does influence behavior and investment and jobs growth and it makes all the sense in the world.

Our motive today in this hearing was not to simply just cast aspersions and beat people over the head, countries that don't necessarily agree with our democratic values or even agree with us on rule of law issues. It is not just to brow beat. Our goal is to use the bully pulpit, as you said, Mr. Glassman. It is to try to encourage other countries of the world to try to employ more free market solutions because that rising tide does lift all boats and it creates jobs and it helps their economies and it helps their people.

And as we started by saying that just by seeing this great spillover of people coming from Central America, the truth is that if they had other things driving their economy other than narcotrafficking, and they do, but I mean narcotrafficking has become such a big part of what is happening in Central America right now that the gang violence, the cartel violence, it has just gotten out of control and if they had security and economic stability, they wouldn't have this crisis. They wouldn't. And we all recognize that.

And so what we are suggesting today for Bolivia, for Argentina, for Ecuador, for Venezuela is that we want to see them succeed. We truly do. We want their people to feel like they are not oppressed. We want their people to feel like they can succeed and they can cover their children's education, that they can put food on the table and that they can have a positive environment to raise their families like we want to have. We are not trying to just humiliate. We are trying to help and edify and that was the purpose of today's hearing was and we hope that it is seen as constructive. I think the panel did a phenomenal job outlining some of the things that can make those countries even better.

Mr. DUNCAN. Will the gentleman, yield?

Mr. SALMON. Absolutely.

Mr. DUNCAN. Let me just say for the record, I am not personally bashing Argentina. I love the country. I love the people. I think

them settling with their creditors would help the economy, it would help their bond rating, and it would give them the ability to actually attract investments. So it is just the suggestion of how to do things, in our humble opinion, better. I don't want that to be misconstrued because I want to see the best for the country. I would love to see them back in that top seven, Ambassador, as economic viability.

Mr. SALMON. Besides the Pope is from there, and you want to get to heaven.

Mr. DUNCAN. I would love to go shoot doves. I yield back.

Mr. SALMON. Thank you very much and this hearing is now adjourned.

[Whereupon, at 3:23 p.m., the subcommittee was adjourned.]

A P P E N D I X

MATERIAL SUBMITTED FOR THE RECORD

SUBCOMMITTEE HEARING NOTICE
COMMITTEE ON FOREIGN AFFAIRS
U.S. HOUSE OF REPRESENTATIVES
WASHINGTON, DC 20515-6128

Subcommittee on the Western Hemisphere

Matt Salmon (R-AZ), Chairman

July 28, 2014

TO: MEMBERS OF THE COMMITTEE ON FOREIGN AFFAIRS

You are respectfully requested to attend an OPEN hearing of the Committee on Foreign Affairs, to be held by the Subcommittee on the Western Hemisphere in Room 2200 of the Rayburn House Office Building (and available live on the Committee website at <http://www.ForeignAffairs.house.gov>):

DATE: Wednesday, July 30, 2014

TIME: 2:00 p.m.

SUBJECT: Building Prosperity in Latin America: Investor Confidence in the Rule of Law

WITNESSES: The Honorable James K. Glassman
Visiting Fellow
American Enterprise Institute
(Former Under Secretary for Public Diplomacy and Public Affairs, U.S. Department of State)

Mr. Paul M. Barrett
Author

The Honorable Jose W. Fernandez
Partner
Gibson, Dunn, & Crutcher LLP
(Former Assistant Secretary, Bureau of Economic, Energy and Business Affairs, U.S. Department of State)

By Direction of the Chairman

The Committee on Foreign Affairs seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202/225-5021 at least four business days in advance of the event, whenever practicable. Questions with regard to special accommodations in general (including availability of Committee materials in alternative formats and assistive listening devices) may be directed to the Committee.

COMMITTEE ON FOREIGN AFFAIRS

MINUTES OF SUBCOMMITTEE ON the Western Hemisphere HEARINGDay Wednesday Date 07/30/2014 Room 2200 RHOBStarting Time 2:05 p.m. Ending Time 3:23 p.m.Recesses ☐ (to) (to) (to) (to) (to) (to) (to)

Presiding Member(s)

Chairman Mott Salmon

Check all of the following that apply:

Open Session ☒Executive (closed) Session ☐Televised ☒Electronically Recorded (taped) ☒Stenographic Record ☒

TITLE OF HEARING:

"Building Prosperity in Latin America: Investor Confidence in the Rule of Law"

SUBCOMMITTEE MEMBERS PRESENT:

Chairman Matt Salmon, Rep. Jeff Duncan, Rep. Ron DeSantis, Rep. Sean Duffy, and Rep. Gregory Meeks.

NON-SUBCOMMITTEE MEMBERS PRESENT: (Mark with an * if they are not members of full committee.)

*Rep. Gerald Connolly*HEARING WITNESSES: Same as meeting notice attached? Yes ☒ No ☐

(If "no", please list below and include title, agency, department, or organization.)

STATEMENTS FOR THE RECORD: (List any statements submitted for the record.)

*Rep. Theodore Deutch- Letter from Frank De Maria, TIG Insurance Company, to Mr. Axel Kicillof, Minister of Economy, Government of Argentina.**Rep. Theodore Deutch- Letter from Frank De Maria, TIG Insurance Company, to the Honorable Cecilia Nahon, Ambassador of the Republic of Argentina to the United States of America.*

TIME SCHEDULED TO RECONVENE _____

or

TIME ADJOURNED 3:23 p.m.

 Subcommittee Staff Director

MATERIAL SUBMITTED FOR THE RECORD BY THE HONORABLE THEODORE E. DEUTCH,
A REPRESENTATIVE IN CONGRESS FROM THE STATE OF FLORIDA

TIG
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July 10, 2014

The Honorable Cecilia Nahón
Ambassador of the Argentine Republic to the United States of America
Embassy of Argentina
1600 New Hampshire Ave, NW
Washington, DC 20009

Re: TIG vs. Republic of Argentina (Caja)

Dear Ambassador Nahon,

I am writing to follow-up with you concerning TIG Insurance Company's (TIG) continued invitation to discuss settlement of its two final judgment debts held against Argentina. TIG's judgments are now valued at approximately \$30.0 million and represent the oldest U.S. judgment debts against Argentina. We have tirelessly attempted an amicable diplomatic approach to achieve settlement. Our efforts have taken up the valuable time of 50 different Congressional Offices in the Senate and House Foreign Relations Committees, Senate and House Judiciary Committees, House Financial Services, Senate and House Appropriations Committees and State Department, all of which have urged Argentina to resolve its debt with TIG. Unfortunately, despite our diplomatic efforts, Argentina has failed even to come to the negotiation table.

Most recently, I replied to your March 5, 2014 letter on April 1, 2014 and followed up with you in a letter dated May 1, 2014. I also understand that you met with Senator Ayotte (NH) in April and she has communicated to you her desire to facilitate a meeting between TIG and Argentina. TIG and Senator Ayotte have not received any response from Argentina on whether or not it will engage TIG in settlement discussions.

I was pleased to read the recent Advertisements from the Office of the Argentine President entitled "Argentina Wants to Continue Paying its Debt But They Won't Let It" in the Washington Post and Wall Street Journal. In the advertisement, your government highlighted that the Argentine Government has paid the IMF, settled with ICSID final award holders, paid obligations to the IADB and the World Bank, has resolved Paris Club debt issue over seven years, settled its dispute with REPSOL, and conveyed its desire to resolve 100% of its obligations.

TIG applauds Argentina's open resolve to settle 100% of its obligations. However, it is very frustrating to learn that Argentina will now participate in settlement discussions with NML Capital and the New York judgment bondholders, and potentially non-judgment bondholders, all of whom were previously unwilling to negotiate with Argentina, yet Argentina continues to ignore TIG's judgments, the US courts who continue to sanction Argentina, and all of the US officials in Washington DC that have sought your assistance in resolving the TIG judgment debts. How can Argentina openly say that

Ambassador Nahon
July 10, 2014
Page 2

it wants to resolve 100% of its obligations and not even respond to a creditor who has held valid and final judgments of the United States federal courts for 13 years?

While TIG prefers an amicable solution, given that Argentina has continued to ignore TIG's judgments and repeated settlement offers, orders of the US federal courts, and the pleas of many US diplomats for Argentina to engage TIG in discussions, TIG has had no other choice but to resort to alternative ways to satisfy its judgments against Argentina. We wish to advise you, as we did with Argentina's counsel of record in the two federal cases in Illinois in which TIG holds judgments against Argentina, TIG has issued subpoenas to numerous U.S. intermediary banks as well as Banco de la Nacion Argentina in an effort to discover Argentine assets. We are also continuing to pursue the ban on the sale of Argentinean wine in New Hampshire and other "liquor control" States.

We reiterate that TIG prefers to resolve this matter amicably, and we are prepared to stay further legal measures provided Argentina consents to a meeting conducted by an Argentine official who has settlement authority. It would seem that this request is feasible at this moment given that Argentine officials will continue to be in the United States for settlement discussions with NMI, Capital and Judge Griesa's court appointed settlement mediator. **Another point that I would make is that as an ongoing commercial enterprise, we have flexibility on the structure of a settlement which could be advantageous to Argentina. For instance, we would be open to discussions on a form of settlement that would include investment in Argentina.**

Finally, if we are able to reach an agreement, we will work with Argentina to create positive publicity that could be of some assistance in your discussions with the bondholders. Certainly, our efforts would include meeting with members of the US Government that we have previously engaged in the past. Please contact me if you are interested in aiding in the resolution of TIG's judgment debt with Argentina.

Sincerely,



Frank J. De Maria
Senior Vice President
TIG Insurance Company

cc: Mr. Alex Kicillof – Minister of Economy
Mr. Jorge Capitanich – Chief of the Cabinet of Ministers
Mr. Carlos Fabrega – President of Central Bank

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August 8, 2014

His Excellency Axel Kicillof
 Ministerio de Economia
 Hipolito Yrigoyen 250 (1310)
 C1086AAB – Ciudad Atonoma de Buenos Aires
 Argentina

Dear Minister Kicillof,

I have written to you on numerous occasions in an effort to initiate settlement discussions concerning TIG Insurance Company's judgment debts against the Republic of Argentina. TIG Insurance Company is the successor by merger to International Insurance Company, which was a reinsured of Caja Nacional de Ahorro y Seguro, whose liabilities were transferred to the Republic of Argentina on July 31, 1998, by Resolución Number 893/1998 of the Argentine Ministry of Economy. I have also written to many other leaders in Argentina on the same matter. Unfortunately, we have not received a single response to requests for settlement discussions. I am writing today, in light of recent comments you made in the press, in hopes that we can find an amicable solution that could even involve TIG's *investment* in Argentina.

Argentina's obligations to TIG Insurance Company go back to judgments obtained in the U.S. District Court for the Northern District of Illinois during the 2000-2002 time period. Judgment in Case No. 00-C-6703 was entered on July 5, 2001, in the amount of \$4,702,428.12. Judgment in Case No. 00-C-2189 was entered on October 9, 2002, in the amount of \$2,276,637.09. The Court also awarded attorneys' fees and has entered sanctions, which continue to accrue, in the amount of \$4,000 per day for Argentina's failure to comply with the Court's orders. Today, with statutory post-judgment interest, the judgments are valued at almost \$29 million. TIG's judgments represent the oldest outstanding debts against Argentina.

Notwithstanding our many efforts to resolve the matter, Argentina has not responded to a single settlement offer. Following Argentina's partial settlement with Bondholder's in 2005, we began to make some progress. In 2008, Argentina's Secretary of Treasury indicated our matter was provided for in Argentina's 2008 budget (See wikileaks cable dated July 24, 2008). In 2011, a meeting was to be held in Buenos Aires. However, the day before the meeting was to take place, a substantial request for documentation was made. TIG has fulfilled Argentina's request for the same documents on three occasions. Since 2011, we have been trying to organize a meeting to discuss settlement. However,

Argentina has willfully ignored the opportunity to resolve the matter amicably while the judgment amount continues to grow.


I recently read your comments given in a television interview about how industrial and business leaders use the vulture fund dispute as an "excuse" not to invest in Argentina. You also indicated that Argentina is an ally of business leaders seeking to invest and said "My doors are always open" to those who want to invest in Argentina. Additionally, Argentina advertises how it has advanced beyond its problems of the past through settlements with ICSID and Paris Club creditors as well as others. However, despite TIG's best efforts, TIG has not been included in any settlements.

While our repeated efforts to engage you over the course of many years have so far been unsuccessful, we would like to provide you with another opportunity to stand behind your words.

TIG Insurance wants to engage Argentina to resolve these long-outstanding debts. TIG Insurance is willing to consider a settlement with Argentina on a basis that could bring rise to an *investment* in Argentina while at the same time not increase Argentina's debt. However, we cannot accomplish such an investment without the attention of Argentina representatives with authority willing to engage in sincere dialogue with us.

I have been to Argentina on this matter on several occasions. My feeling is that Argentina is a wonderful country with very good people. We want you to know that our intention is not to harm Argentina; rather we only seek respect for duties owing under contracts entered into in good faith.

Your attention to this matter and a response would be greatly appreciated.

Sincerely,

 Frank De Maria
 Senior Vice President
 TIG Insurance Company

cc: Hector Timerman, Minister of Foreign Relations of Argentina
 Jorge Capitanich, Chief of the Cabinet of Ministers of Argentina
 Carlos Mascias, Deputy Chief of Mission, of the Embassy of Argentina
 Cecilia Nahon, Ambassador of the Embassy of Argentina
 Kevin Sullivan (Charged' Affaires), US Embassy of Argentina
 Timothy M. Stater (Economic Section), U.S. Embassy of Argentina
 James Koloditch (Commercial Section), U.S. Embassy of Argentina
 The Honorable U.S. Senator Kelly Ayotte
 The Honorable U.S. Representative Carol Shea-Porter
 The Honorable U.S. Representative Anne McLane Custer

Reference id: 08BUENOSAIRE1011 aka Wikileaks id W103475 ?
 Subject: MID-YEAR STATUS REPORT ON BILAT ECONOMIC ISSUES: PARIS CLUB, HOLDOUTS, EXIM TOLLING AGREEMENT, ADVOCACY CASES
 Origin: Embassy Buenos Aires (Argentina)
 Cable time: Thu, 24 Jul 2008 20:49 UTC
 Classification: CONFIDENTIAL
 Source: <http://wikileaks.org/cable/2008/07/08BUENOSAIRE1011.html>
 References: 08BUENOSAIRE976, 08BUENOSAIRE984, 08BUENOSAIRE991
 Referenced by: 08BUENOSAIRE1330
 History:

- Time unknown: Original unredacted version, leaked to Wikileaks
- Thu, 1 Sep 2011 23:24: Original unredacted version published, with HTML goodies

Advocacy cases: Hearing Closure on Bowne, TIG

§13. (C) Relatively good news is that the Finance Secretariat has made some progress over the last year in pushing forward compensation proposals for U.S. companies Bowne of New Jersey and TIG Insurance. MECON has prepared a special decree for the President to authorize payment of the \$1.4 million owed

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to Bowne for publicity work it provided during the 2005 debt exchange. (Bowne printed the prospectus for the exchange, but costs quadrupled when the Italian government demanded a separate, translated prospectus for each of the many thousands of Italian bondholders.) U/S Barboza also has informed Econoffs that MECON also included payment to TIG in the 2008 budget, although Econoffs have not been able to confirm this with the Ministry's Secretariat of Hacienda (Treasury), which controls the budget. (TIG has offered a settlement of close to \$10 million of a dispute pending since the early 1990s.) Post continues to work with the Finance Secretariat to determine the timeline for the resolution of both longstanding disputes.

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February 3, 2014

His Excellency Axel Kicillof
Ministerio de Economia
Hipolito Yrigoyen 250 (1310)
C1086AAB – Ciudad Autonoma de Buenos Aires
Argentina

Re: TIG Insurance Company vs. Caja Nacional de Ahorro y Seguro (“Caja”)

Dear Minister Kicillof,

I am writing to inform you that TIG insurance Company (“TIG”) has been successful in gaining support from New Hampshire legislators in respect of the delisting of Argentine wine products in the State of New Hampshire. Attached please find a copy of Senate Bill (SB) 397, an Act relative to the sale of wines originating from Argentina. This legislation will authorize the New Hampshire Liquor Commission to delist as a product for sale any wines produced in the country of Argentina until the Government of Argentina has satisfied outstanding judgments obtained by TIG against Caja in the United States District Court.

TIG’s action should not come as a surprise. New Hampshire Senator Lou D’Allesandro, the sponsor of SB 397, wrote to Ambassador Cecilia Nahón on June 13, 2013 requesting the Embassy’s help in resolving the debt issue. In his letter, the Senator outlined his intention to work with the New Hampshire Liquor Commission and other legislators on his proposal “to eliminate Argentine wine sales” in the state. We also sent translated copies of the Nahon letter to the Secretary of Legal Affairs (Dr. Prada) and the Senior Coordinator of General Legal Administration (Dr. Carraza).


Senator D’Allesandro and I met in Washington, D.C. with Argentine Minister Eduardo Tempone on September 19, 2013. In this meeting, we requested the urgent assistance of the Embassy in setting up a meeting with Argentine Government Officials who had authority to settle this case. TIG also reached out by phone and electronic mail on December 13, 2013, to the Deputy Chief of Mission Carlos Mascías requested help from the Embassy. This last contact was

made by TIG's adviser, Louis Dupart of Normandy Group. Unfortunately, not a single response was received from any Argentine official.

By way of further background, in the 1970's and 1980's, Caja Nacional de Ahorro y Seguro agreed to reinsure general liability insurance policies that TIG issued to U.S. Fortune 1000 companies. As TIG paid its policyholders for losses covered by the policies, Caja was billed for its share of losses. After Caja failed to honor its obligations under the reinsurance treaties, TIG sued and eventually was awarded two judgments totaling \$6.9 million. Final and non-appealable judgments were received by TIG from the U.S. District Court of Northern Illinois in 2001 and 2002. The judgments were upheld on appeal and the Seventh Circuit Court of Appeals rejected the Argentina government's claim of Sovereign Immunity. The current amount owed to TIG is approximately \$30.0 million.

We remain ready to meet with Argentina officials in Washington to discuss settlement. If we do not receive a response from the Argentine government by February 7, 2014, we will begin sending notice of SB 397 to every major vineyard owner in Argentina advising them of the actions taken by TIG. We also wish to advise that we have started the process of contacting legislators in seventeen (17) other U.S. States that have Alcohol Control Boards as well as the State of California, the largest importer of Argentine wine in the United States, to pursue similar legislation.

In closing, I wish to reiterate TIG's desire to reach a settlement of this debt to the satisfaction of all parties.

Sincerely,

 Frank J. De Maria
 Senior Vice President
 TIG Insurance Company

cc: Cristina de Fernandez de Kirchner, President of the Republic of Argentina
 Amado Boudou, Vice President of the Republic of Argentina
 Hector Timerman, Minister of Foreign Relations of Argentina
 Ambassador Cecilia Nahon, Ambassador of the Embassy of Argentina
 Carlos Mascias, Deputy Chief of Mission, of the Embassy of Argentina
 Eduardo Tempone, Minister, Economic and Commercial Section
 Bruce W. Friedman, U.S. State Department

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April 1, 2014

The Honorable Cecilia Nahón
Ambassador of the Argentine Republic to the United States of America
Embassy of Argentina
1600 New Hampshire Ave, NW
Washington, DC 20009

Re: TIG vs. Republic of Argentina (Caja) April 1, 2014

Dear Madam Ambassador:

I write in response to your letter dated March 5, 2014 to address certain of the points that you raise therein.

First, we respectfully submit that your letter reflects a misunderstanding of TIG's position. You note that TIG has not sought to enforce its judgments in Argentina through the provisions of the Argentine legal system, including Articles 517 through 519 of the Argentine National Code of Civil and Commercial Procedures. As indicated to Minister Tempone in our September meeting, it is simply not necessary for TIG to domesticate its judgments in Argentina – nor is TIG inclined to do so.

In your letter, you “stress” that Argentina “rejects” the notion that it has failed to comply with judgments issued by United States Courts or with arbitral awards. The simple and indisputable facts are that the judgments at issue¹ are *final judgments* of the U.S Federal Courts against Caja Nacional de Ahorro y Seguro (“Caja”) and Caja has not complied with either of those judgments.² We understand Caja to be a commercial instrumentality of the Republic of Argentina.

Pursuant to the unequivocal agreements between Caja and TIG's predecessor-in-interest, Caja voluntarily agreed to be bound by judgments entered against it in the United States. In the contracts containing arbitration clauses, Caja agreed to arbitration in Chicago, Illinois, that the

¹ July 6, 2001 Final Judgment of United States District Court for the Northern District of Illinois in *International Insurance Co. v. Caja Nacional de Ahorro y Seguro*, No. 00-cv-06703, *aff'd* 293 F.3d 392 (7th Cir. 2002)) and October 9, 2002 Final Judgment of United States District Court for the Northern District of Illinois in *International Insurance Co. v. Caja Nacional de Ahorro y Seguro*, No. 00-cv-02189.

² Additionally, the Court, in Action No. 00-cv-06703, imposed sanctions on Caja, after it submitted to the Court's jurisdiction, in the amount of \$4,000US per day, which continue to accrue today, for Caja's willful noncompliance with the Orders of the Court.

TIG
Insurance Company

“decision of a majority of the Arbitrators shall be *final and binding*,” and that “[j]udgment may be entered upon the award of the Arbitrators *in any court having jurisdiction*.” In the contracts that did not contain arbitration clauses, Caja agreed to “submit to the jurisdiction of *any Court of competent jurisdiction within the United States* and *[to] comply* with all requirements necessary to give such Court jurisdiction and all matters arising hereunder shall be determined in accordance with the *law and practice of such Court*.” Additionally, Caja plainly admitted in its Answer to Petition to Confirm Arbitration Award, which Caja filed on November 24, 2000, that the United States District Court for the Northern District of Illinois had jurisdiction to issue a final judgment confirming the enforceability of the arbitral award and that venue was proper. Indeed, the United States Court, to whose jurisdiction Caja willfully submitted, did issue a final judgment confirming the enforceability of the arbitration award.

In pursuing and obtaining awards and judgments in the United States against Caja, due to Caja’s breaches of its reinsurance agreements, TIG’s predecessor-in-interest complied with both the clear contractual provisions that were agreed to by Caja and the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the “New York Convention”). None of the relevant contracts or laws to which they were subject required TIG’s predecessor-in-interest to pursue enforcement of the judgments in any non-U.S. jurisdiction.

A judgment debtor is under a legal obligation to pay final judgments entered against it. A judgment debtor does not have a legal entitlement to decline to comply with the final judgment against it until enforcement proceedings are taken against it, and it certainly is not entitled to violate the final judgment until enforcement proceedings are brought in its preferred venue, even though recognition and enforcement proceedings have already been brought and concluded in the territory where the judgment is being relied upon – the United States – and to whose jurisdiction the judgment debtor agreed to submit. It would inherently undermine the finality of arbitration awards and court judgments if a State against which an award or judgment has been made could make its own compliance with the award or judgment subject to the judgment debtor availing itself of the mechanisms under that State’s own local law for enforcement of final judgments.

Indeed, such a position is plainly contrary to the agreements reflected in the contracts between Caja and TIG’s predecessor and the terms of the New York Convention to which Argentina is a signatory. The New York Convention provides that arbitration awards shall be enforced “in accordance with the rules of procedure of the territory where the award is relied upon.” (Art. III.) TIG relies upon the U.S. award and U.S. federal court judgments in the U.S., where TIG has obtained final judgments. Moreover, the Convention provides:

There shall not be imposed substantially more onerous conditions or higher fees or charges on the recognition or enforcement of arbitral awards to which this Convention applies than are imposed on the recognition or enforcement of domestic arbitral awards.

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(Art. III.) Clearly, to insist that TIG take on the additional onerous burden and expense of initiating exequatur proceedings in Argentina when it has already done all that is required to recognize and enforce domestic arbitral awards in the United States, where Caja agreed to arbitrate and be bound by its Courts, is contrary to the New York Convention.³ Caja voluntarily agreed to submit to and to be bound by the final judgments of the U.S. arbitrators and the U.S. federal courts.

Further, it is our understanding that credits owed to TIG (in the name of its predecessor, International Insurance Company) are registered and acknowledged in resolutions by the Argentine authorities for purposes of processing administrative claims.⁴ TIG and Argentina, through their previous dialogue and TIG's provision of all of the documentation requested by Argentina with respect to these judgment credits, have been proceeding on an administrative basis without any requirement of engaging in exequatur proceedings. TIG has engaged in dialogue with different officials of the National Government, including previous Ambassadors of the Republic of Argentina in the United States. At their request, TIG has repeatedly filed numerous presentations and supplied voluminous documentation, including requests by the National Government within file *S01:0257851/2005*, "*Créditos de International Insurance Company c/ Caja Nacional de Ahorro y Seguro*." Never before in the negotiations and meetings nor in the course of the aforementioned file was TIG notified of any decision or resolution requiring TIG to initiate the legal procedure you reference in your March 5th letter. We also note that the Argentine Government has arrived at transactional agreements with other companies with respect to the debts of Caja without any need for exequatur or judgment execution procedures. There is no valid reason why TIG should be treated any differently.

Accordingly, we do not understand your insistence that TIG engage in additional recognition and enforcement proceedings in Argentina. Argentina is plainly empowered to process and satisfy these judgment credits and is obligated to ensure the satisfaction of these final judgments, which were properly obtained and issued in the U.S. Courts, with whose judgments Caja agreed to comply.

Second, whether the proposed legislation is a violation of any WTO "multilateral trade rules" is a matter between Argentina and the State of New Hampshire, not TIG. We would further note that SB 397 is currently being studied in an interim Senate Study Group, and is not yet in effect. Nevertheless, TIG is confident that the proposed legislation, if enacted, would not violate any trade rules or commitments of the United States. SB 397 is not a protectionist measure designed to promote national products over foreign products. Rather, the proposed legislation would simply permit the State of New Hampshire to act, in its capacity as a "market participant" in the market for wholesale wines, to de-list Argentine wines for sale in New Hampshire until such time as the government of Argentina satisfies the above-referenced judgments. We are confident

³ Indeed, even Argentinean Courts recognize that exequatur is unnecessary where the New York Convention applies. See *Far Eastern Shipping Company v. Arhenpez S.A.* (Federal Court of Appeals of Mar de Plata, December 4, 2009).

⁴ See, e.g., Appendix of reinsurance creditors to Ministry of Economy Resolution No. 893/1998 and Appendix I to Ministry of Economy Resolution No. 232/2003.

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Insurance Company

that the same analysis will apply in the other 17 control states who act as "market participants" in the sale of Argentina wine. We, therefore, respectfully disagree that this matter implicates bilateral relations between Argentina and the United States. Moreover, we simply cannot agree that this legislation is "unjustified," given the fact that Argentina has for more than ten years frustrated and/or ignored TIG's attempt to amicably settle and resolve these valid judgments.

You may not be entirely aware of all of the circumstances and prior dialogue in this matter. We held meetings in Argentina in 2004/2005, we have provided, on numerous occasions, voluminous documentation as requested, and we have patiently worked diplomatically to try to resolve this matter.

Indeed, it is still our hope that we can reach an amicable diplomatic resolution, but as a diplomat you will appreciate that resolution can only occur when parties are willing to discuss matters with a mutual goal of resolution. We would like to work with your office to establish such a dialogue and would be prepared to stall current efforts to de-list Argentina wine products if a timetable for discussions can be agreed.

While TIG is plainly entitled to the full amounts of the final judgments issued by the United States federal courts in its favor, TIG offers, *for purposes of settlement discussions only and wholly without prejudice*, that it will consider alternate means of settling such judgments.

We look forward to your response on these matters as well as our invitation to enter into a meaningful dialogue.

Sincerely,



Frank J. De Maria
 Sr. Vice President
 TIG Insurance Company

cc: The Honorable U.S. Senator Jeanne Shaheen
 The Honorable U.S. Senator Kelly Ayotte
 The Honorable U.S. Representative Carol Shea-Porter
 The Honorable U.S. Representative Anne McLane Custer
 The Honorable Sen. Lou D'Alessandro, New Hampshire Senate
 Mr. Bruce W. Friedman, U.S. Department of State
 Mr. Hector Timerman, Minister of Foreign Relations of Argentina
 Mr. Axel Kicillof, Ministerio de Economia of Argentina
 Mr. Carlos Mascias, Deputy Chief of Mission of the Embassy of Argentina
 Mr. Eduardo Tempone, Minister, Economic and Commercial Section

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FOR SETTLEMENT PURPOSES ONLY

May 5, 2014

The Honorable Cecilia Nahón
Ambassador of the Argentine Republic to the United States of America
Embassy of Argentina
1600 New Hampshire Ave, NW
Washington, DC 20009

Re: TIG vs. Republic of Argentina (Caja)

Dear Madam Ambassador:

I write in connection with our letter to you dated April 1, 2014. While I have not yet received a response from you, it is still our hope that we can reach an amicable diplomatic resolution.

As previously discussed, TIG is plainly entitled to the full amounts of the final judgments issued by the United States federal courts in its favor. The current amount owed by the Argentine Republic to TIG is approximately US\$ 28,255,034. TIG has previously offered, *for purposes of settlement discussions only and wholly without prejudice*, that it will consider alternate means of settling such judgments.

Relatedly, the Argentine Republic entered into an alternative settlement with the holders of the following arbitration awards in October, 2013: *National Grid plc v. The Argentine Republic (UNCITRAL)*, *Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. Argentine Republic (ICSID Case No. ARB/97/3)*, *Azurix Corp. v. The Argentine Republic (ICSID Case No. ARB/01/12)*, *CMS Gas Transmission Company v. The Republic of Argentina (ICSID Case No. ARB/01/8)*, and *Continental Casualty Company v. The Argentine Republic (ICSID Case No. ARB/03/9)* (collectively, the “Settled Arbitration Awards”). Such alternative settlement consisted of compensation in the form of sovereign bonds paid within Argentina.

Like the Settled Arbitration Awards referenced above, TIG’s judgments against the Argentine Republic are enforceable and final with no further means of appeals. Accordingly, TIG respectfully requests that the Argentine Republic promptly take steps to enter into a settlement with TIG on terms substantially similar to the terms provided to the holders of the Settled Arbitration Awards. There will be no binding agreement until and unless there is a written settlement agreement in terms mutually satisfactory to the Argentine Republic and TIG.



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We look forward to your response on the matters raised in our previous letter as well as our current invitation to enter into a settlement on terms similar to the Settled Arbitration Awards.

Sincerely,



Frank J. De Maria
Sr. Vice President
TIG Insurance Company
RiverStone Resources
250 Commercial Street, Suite 5000
Manchester, NH 03101

Cc: The Honorable U.S. Senator Kelly Ayotte
The Honorable U.S. Representative Carol Shea-Porter
The Honorable U.S. Representative Anne McLane Custer
The Honorable Sen. Lou D'Alessandro, New Hampshire Senate
Mr. Bruce W. Friedman, U.S. Department of State
Mr. Hector Timerman, Minister of Foreign Relations of Argentina
Mr. Axel Kicillof, Ministerio de Economia of Argentina
Mr. Carlos Mascias, Deputy Chief of Mission of the Embassy of Argentina
Mr. Eduardo Tempone, Minister, Economic and Commercial Section
Dr. Jorge Capitanich, Chief of the Cabinet of Ministers
Mr. Juan Carlos Fabrega, President of the Central Bank

